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Deriving a normal country
Italian capitalism and the political economy of
financial derivatives

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DERIVING A NORMAL COUNTRY. ITALIAN CAPITALISM AND THE POLITICAL ECONOMY OF FINANCIAL DERIVATIVES

Summary

The financialisation literature is an invaluable resource to explore the expansion of finance in modern capitalism. However, the debate focuses on the US and the UK extensively, whilst being too general with regard to other contexts. This inattention hinders a proper understanding of financialisation in its differential nature across societies. To rectify such limitation, this thesis advances a theoretically controlled and historically informed study about a striking instance of financial excess outside the Anglo-American scenario: derivatives in Italy.

The work argues that scholars are inattentive to the heterogeneous nature of financialisation because they conceptualise the power of finance as entrenched in socio-economic structures. As a result, they underplay the actors who adopt financialised practices differentially. Premised on this critique, the thesis advances an *agency-centred* approach that analyses power from the perspective of agents. In so doing, it examines the diverse traits of financialisation in relation to the specific power struggles in which actors are involved.

Drawing on this method, the work shows that financialisation studies fail to appreciate how key social forces deployed derivatives for political-strategic purposes in the Italian context. During the 1990s, a neoliberal-reformist alliance of pro-market technocrats and centre-left politicians got to power and pushed for Italy to join EMU. This project functioned as an external limit on the domestic political-economic establishment which relied on high public debt, the vast state-owned enterprise and the opaque corporate-governance regime. In brief, citing a slogan widely used in those days, the neoliberal-reformist coalition attempted to make Italy a ‘normal country’ in Europe. Derivatives were crucial in this regard because they helped the Italian government comply with the EMU admission criteria. First, reformists encouraged hedge funds to arbitrage the interest-rate convergence between Italian and German bonds via OTC derivatives markets. Second, they arranged a currency swap that window-dressed the 1997 deficit.

The thesis concludes by examining how other actors adopted derivatives to deal with the neoliberal-driven modernisation of Italy. It studies how the Agnelli family used equity swaps to secure ownership over FIAT and how municipalities manipulated budget restrictions through interest rate swaps.

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List of Abbreviations

ABSs Asset-backed securities

BTPs Buoni del Tesoro Poliennali

CAPM Capital Asset Pricing Model

Cassa DP Cassa Depositi e Prestiti

CBOE Chicago Board Options Exchange

CBOT Chicago Board of Trade

CEA Commodity Exchange Act

CFTC United States Commodity Futures Trading Commission

CIS Credito Industriale Sardo

CME Chicago Mercantile Exchange

COMIT Banca Commerciale Italiana

CONSOB Commissione Nazionale per la Società e la Borsa

CREDIOP Consorzio di Credito per le Opere Pubbliche

CREDIT Credito Italiano

DC Democrazia Cristiana

EMI European Monetary Institute

EMU Economic and Monetary Union

EMU European Monetary System

ENEL Ente Nazionale Energia Elettrica

ENI Ente Nazionale Idrocarburi

EU European Union

EURIBOR Euro Interbank Offered Rate

FED Federal Reserve System

GDP Gross Domestic Product

Ginnie Mae Government National Mortgage Association

ICIPU Istituto di Credito per le Imprese di Pubblica Utilità

IGC Intergovernmental Conference

IMI Istituto Mobiliare Italiano

IMM International Monetary Market (at the Chicago Mercantile Exchange)

IOR Istituto per le Opere Religiose ('Vatican bank')

IPO Initial Public Offering

IRFIS Istituto Regionale per il Finanziamento alle Industrie in Sicilia

IRI Istituto per la Ricostruzione Industriale

ISDA International Swaps and Derivatives Association

ISVEIMER Istituto per lo Sviluppo Economico dell'Italia Meridionale

LIBOR London Interbank Offered Rate

LIFFE London International Financial Futures Exchange

LTCM Long-Term Capital Management

MATIF Marché à Terme International de France

MBSs	Mortgage-backed securities
MIF	Mercato Italiano Futures
MTS	Mercato Telematico dei Titoli di Stato
OTC	Over-the-counter
PCI	Partito Comunista Italiano
PDS	Partito Democratico della Sinistra
PSI	Partito Socialista Italiano
SCIs	Special Credit Institutes
SEC	Securities Exchange Commission
SMEs	Small and Medium-sized Enterprises
SPV	Special Purpose Vehicle
TUB	Testo Unico Bancario
TUF	Testo Unico della Finanza
UK	United Kingdom
US	United States of America

Introduction

Derivatives reached the Italian popular perception in the early autumn of 2007. As the American subprime crisis increased the fear of contagion across the globe, a story of rather local dimensions captured the attention of Italian people: the predatory selling of interest rate swaps to local authorities.¹ This episode gave the impression that Anglo-American finance and its speculative exuberance were taking over Italy.

Local authorities – in particular, municipalities – used swaps extensively since the early 2000s.² These instruments were supposed to help administrators manage their debt structures more actively – for instance, by taking advantage of declining interest rates (Saccomanni, 2007, 17-18). However, swaps turned sour once interest rates rose and it became obvious that the market did not favour the positions of municipalities (Sanderson, Dinmore and Tett, 2010). At this point the controversy exploded. Media attention focused on Anglo-American finance with the accusation of deceiving Italian local governments through complex contracts the implications of which were impossible to grasp. As a popular television documentary about derivatives frauds in Italy explicitly narrated:

[...] all these losses come from the same products: derivatives. London is the motherland of these instruments. Here, the most sophisticated products are engineered to be then sold on the fragile Italian market. Young bankers – aged between 25 and 40 – work in the City of London. They come from the most prestigious American courses on finance. Those

¹In those months, it was not entirely clear to which extent Italian banks were exposed to the subprime excess (Livini, 2007). Later, it emerged that the domestic banking system had a low degree of exposure (Bankitalia, 2008; Quaglia, 2009). For a general timeline about the 2007 financial crisis and its global repercussions, see <http://www.cfr.org/economics/timeline-global-economy-crisis/p18709> [accessed on December 30, 2012].

²In Italy, local authorities refer to municipalities, provinces, metropolitan cities and regions. See Constitution (1947, article 114). This thesis focuses particularly on the case of municipalities (see section 4.4).

who succeed in closing swaps contracts with Italian local authorities receive big bonuses.³ (my translation)

In the following years, this popular perception about Anglo-American finance corrupting Italy became widespread. In the early 2010, a short stop in an Apulian café was enough to capture the common sentiment about derivatives. People in this Southern region – which covers the heel of the boot-shaped Italian peninsula – realised that their communities were exposed to great losses on global financial markets. Coloured by gestures and intense jargon, locals condemned derivatives sellers for swindling money out of honest taxpayers. “It is all about speculation!”, they said whilst commenting on the news regarding a former budget *assessore* for the Apulia region who was tricked by Merrill Lynch in signing a contract he could not understand.⁴ This happened because he neither spoke English nor understood economics and law (Repubblica, 2010). Thus, it seems that, although domestic actors played a facilitating – sometimes naive, often collusive – role in these derivatives frauds, the popular discourse was more inclined to put the blame on the City and Wall Street.

Interestingly, moving from the Apulian café to the world of critical academic research, the current debate on *financialisation* contributes to creating – at least indirectly – this image according to which Anglo-American finance causes disarray elsewhere. To be sure, this literature provides insightful resources to explore the theme of derivatives as one the most remarkable facets of financialisation (Bryan and Rafferty, 2006a; LiPuma and Lee, 2005; Maurer, 2002; Wigan, 2009).⁵ Yet, the

³See *Il Banco Vince Sempre* (bank always wins) at <http://www.report.rai.it/dl/Report/puntata/ContentItem-2a15c777-fc79-424d-b44a-7ca6e51541dd.html> [2’04”]; accessed on December 30, 2012]. The state television RAI broadcast this documentary on October 14, 2007.

⁴Italian regional governments are administered by a president (*presidente*), the regional executive (*giunta regionale*) and the regional council (*consiglio regionale*) as the legislative body. See Constitution (1947, article 121). Members of the executive are called *assessori regionali*. Each *assessore* has responsibility for a specific department such as budget, health, environment and so on. Members of the council are known as *consiglieri regionali*.

⁵For instance, the work by Duncan Wigan (2008, 2009) is particularly relevant to appreciate how derivatives uphold financialisation in its proceeding semi-autonomously from tangible wealth production. Echoing the groundbreaking research by Dick Bryan and Michael Rafferty (2006a) – see section 1.1.2 – Wigan argues that derivatives perform the role of ‘artifices of indifference’ through an unprecedented transformation of ownership flexibility that transcends the joint-stock form. Derivatives further abstract ownership away from any direct (partnership) or legal ownership (joint-stock) of tangible assets. For instance, the owner of an equity derivative does not own the actual underlying shares and has no voting rights on the board of the company that issued those shares. She owns only the exposure to an attribute of these shares: price volatility. According to

debate reveals a weak spot. It tends to focus extensively on the institutions and discourses of the United States of America (US) and the United Kingdom (UK), whilst being too general when it comes to examine other societies (Engelen, Konings and Fernandez, 2010, 57). This is problematic because, due to such inattention, the financialisation debate falls short of providing the analytical space where to explore how and why people outside the Anglo-American heartland experience financialised practices through modalities that are institutionally and discursively diverse.⁶ As a consequence of this, the debate underplays the actors who had a decisive role in pushing for financialised reforms in societies other than the US and the UK. Ultimately, by disregarding this dimension, the financialisation literature cannot challenge the Italian popular discourse which underrates the significance of domestic affairs relatively to the perils of an external threat.

The argument

Considering the events above, this thesis explores the political economy of financial derivatives in Italy.⁷ It does so by engaging with a problématique that currently animates the debate on financialisation: the distinct trajectories of financialised phenomena across societies.

In recent years, encouraged by the subprime crisis and its differential impact throughout the globe, several scholars have begun to map how financialisation affects societies and areas outside the US and the UK.⁸ This line of research aims at improving the analytical resources of a ‘first generation’ of works which has focused

Wigan (2009, 160-163, 167), it is on the basis of this flexible ownership that derivatives crucially support finance-based accumulation. In fact, derivatives ownership disengages investors from the competitive requirements at the level of real wealth production. In the case of the joint-stock form, competition still gravitated at the interstice of production and circulation. On the contrary, derivatives emphasise instead the circulative dimension, constructing a system in which investors have a diversity of exposures to price volatility and the risk which the latter entails.

⁶The terms ‘institution’ and ‘discourse’ – alternatively, institutional and discursive – are used together to denote the intertwined material and ideal nature of human practices.

⁷For an overview about the origins and evolution of political economy, its various approaches, their ontological and epistemological foundations, see Van der Pijl (2009).

⁸For some interesting studies about financialisation outside the Anglo-American economies, see: Daniela Gabor (2010) on Eastern Europe; Annina Kaltenbrunner (2010) on Brasil; Thomas Marois (2011) about Mexico and Turkey; Juan Pablo Paineira (2010) on Brasil and Korea; Ewald Engelen, Martijn Konings and Rodrigo Fernandez (2010) on the Netherlands; Stockhammer (2008) on Western Europe; Orsi and Solari (2010) on Southern-Europe including Greece, Italy, Spain and Portugal.

exclusively on the Anglo-American space. Taking into account these current studies on the heterogeneous nature of financialised developments, this thesis advances the following central argument: *the financialisation literature underplays how and why financial expansion differs across societies because it tends to view finance from the vantage point of structural power*. What does this argument entail?

Many critical scholars articulate the power of finance as entrenched and replicated in the structures of society. Through this exercise, they theorise the general dynamics of a finance-driven reality that produces dramatic inequalities and, for this reason, should be transformed. In this regard, they conceptualise agency – either explicitly or implicitly – as an act of resistance against the powerful structures of finance.⁹ However, in spite of acknowledging agency, scholars eventually relegate it to a stand-by status and reactivate it only in moments of crisis – when actors can fulfil the objective of changing society for the better. Thus, agents are never properly explored in their ability to adapt the practices of financialisation in a differential manner and for historically specific reasons. This leads to an idea of financialisation which expands as a quasi-homogeneous entity.

Against this view on finance through the lenses of structural power, this thesis presents an *agency-centred* approach as a methodological turn in the financialisation debate. This perspective accounts for a social reality where agents are not passive bystanders against the power of finance. On the contrary, actors interact with each other through the mediation of constantly renegotiated institutional and discursive architectures. In this context, power is not entrenched in the structures of society, but generated by agents when they manipulate extant institutions and discourses in search for a leverage to exert power over others (Knafo, 2010; Konings, 2010b). As this thesis claims, *the agency-centred approach provides the historically sensitive scenario where to appreciate how and why Italian agents – through their conflicts as well as their institutional and discursive manipulation – produce different traits of financialisation across social spaces*.¹⁰

In fact, once applied to the case of derivatives in Italy, the study shows that these practices always acquire different contours depending on the power struggles

⁹The critique of the view on agency as an act of resistance against structural power is based on Knafo (2010). Chapter one examines this aspect more in depth.

¹⁰This thesis adapts the term ‘social space’ from Lefebvre (1974). It shows that the heterogeneous character of financialisation does not necessarily reflect nation-state boundaries, but rather the spaces in which social forces unfold their conflictual relations.

in which they are deployed. Over the course of the 1990s, Italian neoliberal-minded technocrats and centre-left politicians (henceforth neoliberal reformists) attempted to challenge the country's old political and business elites by implementing a market-oriented modernisation of Italian capitalism.¹¹ This process was undertaken in line with the objective of joining the Economic and Monetary Union (EMU) in 1999. Participating in the EMU from the very start was a chance not to be missed due to the fact that Europe functioned as an external constraint on those conservative forces who depended heavily on: high public expenditure, the enlargement of the state-owned enterprise and a blockholder-oriented regime of corporate governance.¹² In other words, neoliberal reformists adhered to the dynamics of European economic and monetary integration in order to – citing a slogan which centre-left leaders used extensively – make Italy a ‘normal country’.¹³ This process of normalising Italy implied an attempt by reformist forces to replace old political-economic practices – which had become systemically clientelistic and corrupt by the late 1980s and early 1990s – with the institutions and discourses of a modern liberal democracy (Favretto, 2002, 403).

Derivatives played a crucial role in these tactics. Indeed, as chapter four explains, neoliberal reformists tailored these innovative instruments to their strategic requirements vis-à-vis conservative forces. In so doing, derivatives-based techniques acquired distinct traits in relation to the nature of the Italian power struggle and the agents who were involved in it. Initially, technocrats introduced derivatives whilst renovating the practices and technology of public-debt management. After this, as the struggle to conform with the EMU criteria intensified, derivatives practices be-

¹¹The terms ‘neoliberal-minded’, ‘neoliberal’ or ‘neoliberalism’ denote the ideology according to which “human well-being can best be advanced by liberating individual entrepreneurial freedoms and skills within an institutional framework characterized by strong private property rights, free markets, and free trade” (Harvey, 2005, 2). Of course, the emphasis on the free market and the retreat of the state is a rhetorical matter. In reality, neoliberal forces capture state institutions and exploit them to secure their discipline over society (Konings, 2010a).

¹²About Europe as an external constraint on Italy, see Dyson and Featherstone (1996) and Sbragia (2001). About the market-oriented transformation of Italian finance and its impact on corporate blockholders, see Deeg (2005b), Cioffi and Hopner (2006) and Culpepper (2007).

¹³The Italian translation is *un paese normale*. This rather vague slogan was the title of a book by Massimo D'Alema (1995), a leading centre-left politician and President of the Council of Ministers (1998-2000). See <http://www.governo.it/Governo/Governi/dalema1.html> and <http://www.governo.it/Governo/Governi/dalema2.html> [both accessed on December 30, 2012]. As chapter four shows, the slogan reflected the shift of post-communist leaders towards neoliberalism (Ginsborg, 2001, 302-303).

came a quintessential element of reformists' agential power. In particular, these actors stroke a 'devil's bargain' with the most aggressive hedge funds in the attempt to arbitrage the interest-rate convergence between Italian and German bonds via the over-the-counter (OTC) derivatives markets (Dunbar, 2000, 153). In addition to this, reformists arranged also a controversial currency swap which window-dressed the 1997 budget deficit only to disburse a larger amount of money later on (Piga, 2001, 122-129).¹⁴ These highly financialised operations did not simply reflect a degree of subordination to Anglo-American finance and its crisis-prone practices. From an 'inside-out' perspective (Panitch, 1996), they reveal instead how Italian reformists set in motion finance-led strategies in order to achieve their political priorities in the context of domestic power relations.

It is important to note that the agential process of constructing institutional and discursive structures does not lead to the consolidation of an objectified reality. On the contrary, it allows people to use those structures for their own strategic purposes (Konings, 2010*b*, 65-72). In other words, whilst neoliberal reformists in Italy exerted power by building market-oriented institutions and discourses, other agents lived such constraints in their own terms – eventually transforming the very same restrictive rules they were initially subjected to (Knafo, 2010, 503). As chapter four shows, this aspect is fundamental to appreciate how and why actors other than neoliberal reformists – such as corporations or municipalities – adopted derivatives techniques to develop their own tactics.

General contours of the work

This thesis is structured in six main parts. It begins with a technical excursus on derivatives markets, instruments and actors. This primer aims at facilitating the reader's comprehension of this complex topic in preparation for the study provided in the work. The analysis explains primarily the mainstream 'textbook' understanding of derivatives.

Successively, chapter one interrogates the theoretical insights of the financialisation literature by looking at four main approaches: Régulation school together

¹⁴As chapter four shows, European member states decided which country could have joined the first round of EMU on the basis of the macroeconomic data for the year 1997. The level of budget deficit came to play a pivotal role amongst all the Maastricht convergence criteria.

with post-Keynesian economics, Marxist political economy and Foucauldian political economy. The study claims that the structural bias of these approaches limits their ability to examine how and why societies outside the Anglo-American heartland adopt financialised practices. For this reason, scholars fall short of capturing many institutional and discursive specificities of the Italian case. Hence, the chapter reconsiders financialisation from the vantage point of the agency-centred approach. This is an alternative method which accounts for the differential trajectories of financialised phenomena (e.g. derivatives) across social spaces.

Premised on this, chapter two explores the origins and evolution of derivatives-based risk management in the United States. Before examining the specificities of the Italian case, it is necessary to detour our analysis around Italy to focus instead on the American context. This is because – as the chapter claims – derivatives-like instruments existed for millennia (Swan, 1999), but only in the US did these contracts assume their modern features and were then projected across the globe as part and parcel of American financial power. It is shown how derivatives were systematically disconnected from the final delivery of the underlying asset during the late nineteenth century. This innovation generated dramatic speculative trading and attracted the opposition of the rising populist movement. In a scenario of intense power struggle, representatives of commodity markets recast their speculative activities as essential instruments of business-risk management. As a result, speculation on futures markets was gradually institutionalised in such terms (Levy, 2006).

At the turn of the 1970s, power relations in the American society increasingly favoured finance. This was due to the fact that the US establishment began to support the expansion of financial innovation at home and abroad as a mechanism of ‘pure dollar’ hegemony. In a word, the practices of American finance turned into an effective instrument of state power in the global order (Gowan, 1999; Konings, 2009; Panitch and Gindin, 2008). Under these circumstances, representatives of commodity exchanges successfully lobbied for the creation of organised markets where to trade financial derivatives (MacKenzie and Millo, 2003; MacKenzie, 2006). In this regard, the discipline of financial economics was crucial in providing scientific legitimacy to derivatives as useful instruments that protect investors from the risk of market volatility (Wigan, 2009). Over the course of the 1970s, derivatives grew in trading volumes and types – although these developments were to some extent

hindered by regulatory uncertainties. Finally, from the early 1980s onwards, these instruments became essential constituents of American financial power in a dollar-centred world economy. Accordingly, other societies began to adopt themselves the practices of derivatives-based risk management.

How and why did the Italian society import derivatives-based risk management? Why and to what extent do this innovation reveal distinct features in Italy? The third chapter moves from the United States to the Italian case. It provides the historical background to capture the domestic actors and the power struggles which gave derivatives its specific traits in the Italian context. The chapter claims that capitalism in Italy evolved through an ownership liaison between private business oligarchies and the expanding public enterprise (Segreto, 1998). This equilibrium secured ownership in the hands of the state and the oligarchs, a scenario which reached its most collusive and corrupt traits during the 1980s. It is at this point that technocrats – based primarily at the Bank of Italy and the Ministry of Treasury (Deeg, 2005*a*) – launched a critique of the Italian political economy which exalted the benefits of reducing public debt, privatising the state-owned sector and, a few years later, modernising the domestic financial system in favour of dispersed shareholding. Through their pro-market critique, technocrats aimed at undermining the foundations upholding conservative politics-cum-business affairs. In fact, whilst the political establishment depended on the enlargement of public debt (Pasquino, 2000, 79) and the clientelistic exploitation of the state enterprise (Bianchi, 1987), private capital benefited from cross-shareholding alliances and pyramidal schemes to the detriment of minority shareholders (Amatori and Colli, 2001; Bianchi, Bianco and Enriques, 2001).

The ideas put forward by technocrats became influential in the late 1980s and early 1990s, when the process of European integration revealed a new impetus with the launch of the single market and the project of monetary union. In a context where the political-economic establishment and the popular discourse were supportive of Europe in a general sense (Quaglia, 2011), crucial reforms were introduced such as the removal of capital controls, the transformation of public banks into joint-stock companies and the independence of the central bank. Above all, technocrats gained considerable power over the policy contents during the intergovernmental conference (IGC) on EMU. In February 1992, by adhering to the convergence criteria for joining

EMU, they imposed an external discipline on the country's vested interests and their reproductive capacities (Dyson and Featherstone, 1996). At this point, the stage was ready for neoliberal reforms to be implemented in a systematic manner over the course of the 1990s. Derivatives practices emerged and consolidated in Italy under such circumstances.

Having explored the power relations in which technocrats advanced their pro-market critique of Italian capitalism, chapter four examines instead the distinct traits of derivatives-based risk management in Italy. The study claims that this innovation acquired specific contours in relation to the uniqueness of Italian power dynamics – in particular, the strategies that neoliberal reformists launched against conservative political-economic forces. The analysis begins by showing how technocrats became increasingly impatient towards the inability of political elites to rein in the budget deficit. In this context, they marketised the practices of public-debt management. Derivatives were introduced as part and parcel of this transformation. These instruments were deemed to make government bond markets more attractive to investors.

After this, the chapter enters the core of the story by examining the period 1992-1999. During these years, technocrats and centre-left politicians implemented draconian austerity measures and market-oriented reforms in line with the strategic objective of joining EMU. As the fight for Europe heated up, these actors deployed derivatives as their most strategic element. In particular, they encouraged the hedge fund Long-Term Capital Management (LTCM) – and indirectly other financial actors – to narrow the interest-rate spread between Italian and German bonds via arbitrage operations on the OTC derivatives markets (Dunbar, 2000, 149-162). More controversially, reformists entered also into a fraudulent currency swap through which they window-dressed the 1997 budget deficit (Piga, 2001, 122-129).

Finally, chapter four looks also at how other agents experienced the market-oriented institutions and discourses which neoliberal reformists advanced. The analysis shows that the 'enabling' (Konings, 2010*b*) character of these structures allowed the Agnelli family (FIAT) and Italian municipalities to adopt derivatives strategically. Indeed, whilst the Agnelli used equity swaps to secure ownership over their corporate empire, municipalities 'got high' on interest rate swaps in order to circumvent the budget restrictions imposed by the European stability and growth pact.

Last but not least, the concluding chapter highlights the main findings of the thesis and the implications for future research. Moreover, it presents also a brief overview about the general dynamics of financialisation in Italy.

Technical excursus: a primer on derivatives

What are derivatives? How do they work? Who are the actors using them and for what purpose? This technical excursus addresses these questions by examining the fundamentals of derivatives markets, instruments and actors. After a brief outline of the main types of derivatives, their respective underlying referents and the markets where these instruments are traded, the analysis proceeds by studying the basic logic of forwards and futures. Successively, the second section explains the orthodox rationale behind the use of futures – and, more generally, derivatives – as well as who uses these instruments. After this, the primer examines the other basic types of derivatives such as options/warrants and swaps. Finally, the last section concludes with a simple example of asset-backed securities (ABSs). This shows the important linkage between derivatives-based techniques and the practices of securitisation.¹⁵

Definition, types of instruments and markets

A conventional definition sees a derivative contract “as a financial instrument whose value depends on (or derives from) the values of other, more basic, underlying variables” (Hull, 2009, 1). In other words, the value of the derivative stems from the

¹⁵Unless otherwise referenced, this technical excursus is based on Kolb and Overdahl (2006, 2007) and Hull (2009). For what concerns instead the subsection on securitisation and asset-backed securities, the analysis primarily refers to Fabozzi and Kothari (2008). It is important to note that, although these core textbooks clearly illustrate the complex mechanics of derivatives, their understanding of these instruments is mostly ahistorical. In particular, their view on derivatives as tools of risk management – via hedging practices and liquidity-enhancing speculation (see below) – hardly captures the infinite strategies through which actors might adopt these instruments on the ground. For this reason, this primer is only meant to facilitate the reader’s comprehension about the mainstream conceptualisation of derivatives markets, instruments and participants.

price volatility of the underlying asset. There are four basic types of derivatives:

- forwards;
- futures;
- options and warrants;
- swaps.

These four ‘plain vanilla’ instruments are the standard versions of derivatives. Other ‘exotic’ types alter their features to combine different profiles, creating more complex and synthetic products. To simplify the analysis, this section deals only with plain vanilla derivatives.

For a long time in history, contracts similar to forwards, futures and options were traded primarily on agricultural products and commodities (Swan, 1999). Today, particularly after the emergence of swaps in the early 1980s, derivatives on financial assets represent instead the most widely traded instruments. Listed in descending order according to market size (BIS, 2008, 2011), modern derivatives refer to five different categories of underlying assets:

- interest rate – e.g. interest rate swaps, interest rate futures, forward rate agreements;
- foreign exchange – e.g. currency swaps, currency futures, currency options, currency forwards;
- credit – e.g. credit default swaps, total return swaps, collateralised debt obligations;
- equity – e.g. stock options, warrants, index futures;
- commodity – e.g. commodity futures, commodity options, commodity swaps.

Other contracts are also traded on underlying referents such as: property index; macroeconomic indicators; freight rates; weather forecast; Co2 emissions and so on. This indicates the possibility for derivative-based techniques to be applied to

many aspects of our social reality, a question which complicates the above-mentioned conventional definition of derivatives (Bryan and Rafferty, 2006a, 64).¹⁶

Derivatives are bought and sold on two types of markets which differ in terms of trading arrangements, procedures and levels of risk. These two markets are:

- organised exchanges;
- OTC markets.

An organised exchange is a centralised marketplace for buyers and sellers of derivatives contracts, regulated by government agencies such as the US Commodity Futures Trading Commission (CFTC). Bids and offers can be based on an *open outcry* system or on electronic trading. Today, most of the exchanges trade through computer-based platforms (Gorham and Singh, 2009). Organised exchanges offer instruments which are standardised in terms of quantity, quality, expiration months, delivery terms, delivery differentials, delivery dates, minimum price fluctuations, daily price limits, trading days and hours. For this reason, contracts can be easily transferable to third parties through the market. The major benefit of organised exchanges is the use of the central counterparty system of clearing and settlements.

The *clearing house* is the counterpart in each trade, effectively intermediating between the seller and the buyer. In other words, it is the clearing house which sells the contract to the buyer and buys it from the seller, clearing and settling the contract (Loader, 2005). This method dramatically reduces the risk of default through the system of so-called *margins*. Indeed, market participants are required to register an account with the exchange from which money is withdrawn or credited according to the daily profits and losses. In so doing, they adhere to the margins system. Contrary to securities markets where ‘trading on margins’ means buying stocks through borrowed money, in derivatives markets margins include: the *initial deposit* of ‘good faith’ made into the account in order to enter the market; the *maintenance margin*, which is the lowest amount an account can reach before being topped up; the *margin call* as that sum which needs to be deposited in order to bring the margin back to the initial amount. These margins are usually very low

¹⁶On property derivatives, see Smith and Searle (2010). On macroeconomic derivatives, see Gurkaynak and Wolfers (2006). On freight derivatives, see Alizadeh and Nomikos (2012). On weather derivatives, see Jewson and Brix (2005). On carbon emission derivatives, see Sandor (2012). About the role of financial innovation in society, see Shiller (2003) and Bryan and Rafferty (2011) for a critique.

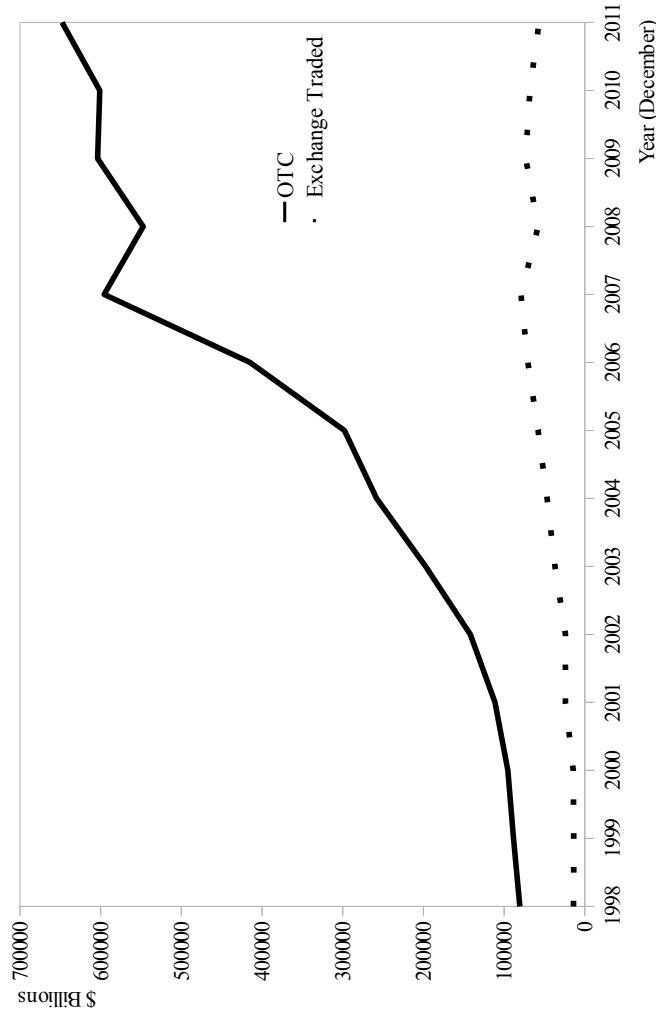


Figure 1: Notional amount (\$ billions) of financial derivatives on global OTC markets and organised exchanges, 1998-2011.

Source: own elaboration from data by Bank for International Settlements (BIS) Quarterly Reviews; see http://www.bis.org/publ/qtrpdf/r_qt1206.htm [accessed on December 30, 2012]. It is important to note that these numbers are obviously notional amounts. For instance, in an agreement to buy 10 million British pounds with euros at a pre-established exchange rate in six months, the notional amount is 10 million British pound. However, the market value of such contract might be only 100 thousand pounds. In this regard, it is important to estimate the gross market value of all outstanding derivatives contracts at a given date, as BIS does.

compared to the control over large cash amounts of commodities an individual can exert. This means that with a relatively small amount of cash, investors can enter into derivatives worth much more than the required initial margin deposits – a characteristic known as *leverage*.

Contrary to organised exchanges – where derivatives are standardised in terms of quantity, quality, delivery date and place – OTC markets are instead decentralised networks where financial institutions tailor instruments to fit certain requirements of their clients. Due to the benefits of trading customised products, OTC markets expanded overwhelmingly compared to formal exchanges (see figure 1). However, OTC markets have no central clearing house which intermediates between buyers and sellers. Here, derivatives are privately negotiated between the two parties. In this regard, these markets imply a considerably higher exposure to credit risk. For this reason, initiatives were developed to minimise risk on OTC markets.¹⁷ To begin with, contract details are subject to market standard documentation such as the Master Agreement by the International Swaps and Derivatives Association (ISDA). Furthermore, similar to the central counterparty model, LCH.Clearnet operates a clearing system for interest rate swaps known as SwapClear (Loader, 2005). In spite of this, it is evident that OTC markets simply function by linking various trading floors amongst the major financial institutions. There is “no central mechanism to limit individual or aggregate risk taking, leverage, and credit extension, and risk management is completely decentralized.” At the level of transparency, besides semi-annual surveys by central banks, “information about market concentration and who owns which risks is generally unavailable; at best, a trading desk might know that some institutions are building up positions” (Schinasi et al., 2000, 19).

Table 1 presents a schematic view of the four basic types of derivatives in relation to the respective markets in which they are traded. As it is clear, options are the only instruments traded on both exchanges and OTC markets. Forwards and swaps are instead a prerogative of OTC markets, whilst futures are exclusively traded on organised exchanges. Let us now move to examine each basic instrument in turn.

¹⁷In this regard, the growing market for credit default swaps can be seen as a way to minimise credit risk on OTC markets.

Instruments	Exchange traded	Over the counter
Forwards	No	Yes
Futures	Yes	No
Options	Yes	Yes
Swaps	No	Yes

Table 1: Types of derivatives instruments and their respective markets.
Types of derivatives instruments and their respective markets.

Forwards and futures

The use of contracts with forwards-like features goes back to ancient Babylon (Swan, 1999). The objective was to set the price today for a sale of an asset in the future. Until the Mercantile era, the assets in question were commodities, but shares of the Dutch East India company and the Dutch West India Company began to be traded on a deferred basis during the period of the Dutch Republic (1581-1795) (Gelderblom and Jonker, 2005). These were early antecedents of modern financial derivatives. In order to explain the rationale behind a forward contract, let us take the classical example of a wheat farmer and a flour miller.¹⁸

Instead of awaiting the crop to be ready and then trade wheat at the prevailing market price, the farmer and the miller agree in advance on a specific price, quantity and date of delivery of the wheat in the future. Once the crop is harvested and ready to be sold, the market-prevailing price at harvesting time could be either above or below the price previously agreed on in the contract. The first case favours the miller. In fact, because of the contract, she pays less for the wheat than what she would pay if buying the commodity at the market-prevailing price. The second case favours instead the farmer who, due to the contract, is being paid more than what others pay on the market. In spite of this seemingly one-sided bet against the future price of wheat, both parties gain in business certainty and price stability.

In the second half of the nineteenth century, merchants in Chicago revolutionised the modalities of forwards-like contracts which at that time were called *to-arrive*. As chapter two shows, the Chicago Board of Trade (CBOT) established the first market for standardised to-arrive contracts known as futures. These were contracts

¹⁸The example is based on Bryan and Rafferty (2006a, 41).

in which details such as the quantity and quality of the commodity, the price per unit, the date and delivery arrangements were all specified. After the CBOT, other markets for futures soon flourished across the United States. Grains, and particularly wheat, were the most traded commodities on these markets. Today, organised futures markets exist across the world. They expanded their range of products to include options and, as already mentioned, financial assets as the underlying referents. How does a futures market function?

An organised futures exchange is a centralised marketplace for buyers and sellers of futures contracts. Referring again to the above-mentioned example of the miller and the farmer, let us imagine that on March 5th the miller gives instruction to a broker to enter into a future which requires to buy 5,000 bushels of wheat in July. In the same period, the farmer instructs another broker to enter into a contract to deliver 5,000 bushels of wheat in July. As the party who agrees to buy the commodity, the miller is in the *long position* (going long). The farmer is instead in the *short position* (going short) as she agrees to receive the commodity. Each contract always involves both positions. Under an open outcry system, floor traders would meet up to agree on a price. On an electronic platform instead, brokers would match bids and offers via computer-trading networks. The price agreed – let us say \$4 per bushel – is the current *futures price* for July wheat, which is subject to fluctuations in supply and demand.

Conceptually, futures are very similar to forwards since both contracts involve the future delivery of an asset at a price agreed today. However, there are three key differences. First, the two instruments are traded on different markets. Being standardised products, futures are bought and sold on organised exchanges. On the contrary, forwards are traded on OTC markets. Second, the miller and the farmer do not meet up personally, but refer to their brokers which in turn relate to the exchange's clearing house as their counterpart. In other words, it is the clearing house which sells the wheat to the miller's broker and buys it from the farmer's broker, clearing and settling the contract. As already mentioned, this system dramatically reduces the risk of default through margins requirements. Indeed, the farmer's and the miller's respective brokers are required to register an account with the exchange, from which money is withdrawn or credited according to the daily profits and losses, as well as to conform to margins. Third, and this is a fundamental innovation in

derivatives trading, the two parties are not bound to exchange the actual commodity at the expiration of a contract. The majority of futures position are *closed out* before being *exercised* at expiration, making the market for futures work practically through a process of cash settlement. Profits and losses are calculated on the basis of the daily price movements of futures, whilst the accounts of both long and short positions are therefore adjusted for gains and losses at the end of each trading day.¹⁹

Since futures can be easily closed out before expiration, exercising the contract for delivery is very unusual and traders often forget how the actual delivery process works. Closing out a position means entering into a contract which is the opposite of the original one. For example, the miller – who bought a July wheat futures contract on March 5th – can close out the position by instructing the broker to sell one July wheat futures contract on, say, May 6th. The farmer who is in a short position would do the opposite. In both cases, total gain or loss are determined by the difference in the futures prices between the day in which they entered the first contract (March 5th for the miller) and the day when the contract is closed out.

What is the reason for futures and other types of derivatives to exist? The next section presents a practical case of futures trading that shows the rationale behind the use of derivatives and who uses them. Successively, the analysis focuses on other types of derivatives and their specifics.

Why do derivatives exist? Who are the actors using them?

The orthodox argument is that futures markets and their speculative mechanisms provide a fundamental function of risk management. Chapter two shows that this idea emerged out of specific social relations of power in the United States during the late nineteenth century, at a time when the country experienced a dramatic transformation of its agricultural and urban landscapes. Against populist attacks, advocates of futures markets advanced the powerful argument that these organisations – as

¹⁹For instance, a week after the miller and the farmer entered into their contract of \$4 per bushel, the price of wheat futures increases to \$5 per bushel. In this case, the farmer has lost \$1 per bushel, whilst the miller has profited by \$1. Accordingly, the farmer's account is debited \$5,000 (\$1 per bushel x 5,000 bushels) and vice versa for the miller. This is very different from the stock market. Here, gains and losses deriving from price movements are realised only when the investor decides to sell the stock or cover the short position.

well as the speculation which characterised them – helped businessmen hedge their risks. In this regard, commodity traders were not gamblers but professionals who managed such risk in scientific terms. This reinterpretation of speculative activities shaped extant institutions and discourses in the United States at the turn of the twentieth century. As a powerful idea, it legitimised futures trading as an efficient dimension of the American economy. What is more, it was rhetorically adopted across the world. To appreciate what *derivatives-based risk management* entails, let us refer to a historical example which chapter two further examines in its significance.

Andrew J. Sawyer, an important market participant, testified before the House Committee on Agriculture in February 1892, during the hearings about the Hatch bill.²⁰ Residing in Minneapolis, Sawyer had been president of the Duluth Board of Trade in 1881 and was also a member of the Minneapolis Chamber of Commerce as well as the CBOT. He owned a 5,000-acre wheat farm in Minnesota and one of the leading grain elevator businesses in the Midwest. He dealt exclusively in wheat, the harvest season of which began in July. After purchasing the wheat from the farmers, he stored it in the elevators and then shipped to both Minneapolis and Duluth. In the latter case, the wheat was mostly destined for foreign markets. Sawyer testified in front of the Committee that he used the futures markets for hedging purposes. How did this work practically? Imagine that “we are handling 100,000 bushels a day and we can sell in Minneapolis, Buffalo, Montreal, or New York only 75,000 bushels a day [...] We have then 25,000 bushels left on our hands which we can not sell, there being no market for it” (Levy, 2006, 312). Sawyer decided to hold these 25,000 bushels until the market would turn in his favour. But, what would have happened if after six months the price for wheat had declined even further? In this sense, he needed to protect his business from such possibility. It is at this point that futures trading entered Sawyer’s operations. He shorted wheat futures to traders in the CBOT pits. If two days after entered into the contract, the current market price was below the contract price, Sawyer had profited. He would close out his position, obtaining the capital necessary to keep storing the 25,000 bushels. On the contrary, if the futures market price had turned against him, Sawyer would have incurred losses on his futures position. However, in this case, he would have at least delivered the 25,000 bushels of wheat on the *cash market*, where the actual commodity is

²⁰The example is based on Levy (2006, 312-313). On the Hatch bill hearings, see section 2.1.

bought on the spot.

Sawyer represented a typical example of *hedger*, a market participant who used futures contracts as a form of insurance against the risk involved in his business operations. In other words, he speculated on futures markets, but only with the intention of either closing out his position before expiration – therefore making a profit to be reinvested in his business – or effectively delivering the actual commodity at the end of the contract. However, futures markets attracted many traders who were hardly interested in the actual exchange of wheat. In fact, contracts were only rarely exercised at expiration. How did futures markets advocates justify the presence of *speculators* in the pits? Although compared to gamblers by the people outside the exchanges, speculators nonetheless appeared to other market participants as essential *providers of liquidity*. By buying and selling contracts in search for a profitable trend, they went long or short when they anticipated prices to respectively increase or decrease. In so doing, whilst satisfying their thirst for quick profits, speculators made sure that hedgers like Sawyer always found counterparts to their actual trading needs (Levy, 2006, 325).

The distinction between hedgers and speculators is widely acknowledged by the contemporary literature on derivatives. The two broad categories circumscribe a myriad of market participants such as banks, institutional investors, central banks, government agencies, supranational institutions, companies, wealthy individuals and retail investors. These actors, either directly or indirectly, enter into futures and other derivatives contracts to *hedge* risk or *take* risk. Paradoxically, the two facets are intertwined and support each other efficiently. Besides hedgers and speculators, a third type of market participant is the *arbitrageur*, who identifies price discrepancies and profit from them.²¹ Investors adopt many strategies involving derivatives instruments, the name of which are often very odd – e.g. spreads, butterfly, straddle, strangle and so on (Cboe, 1995). These names may confuse the reader. But, all these and other names represent sub-specific practices which are broadly conceived with the intentions to hedge, speculate or arbitrage.

²¹The concept of arbitrage plays an important role in options pricing theory (see chapter two). A discussion of the numerous arbitrage techniques is beyond the scope of this work. For two studies on arbitrage both at the theoretical and practical level, see MacKenzie (2003) and Dunbar (2000, 34-37, 60-66).

Options and warrants

Besides forwards and futures, options and warrants are the other basic instruments. Options existed for a long time and with various names, notably *privileges* in eighteenth and nineteenth-century England. However, their use on both commodities and stocks was always controversial and often restricted (Swan, 1999). Options and warrants were eventually legitimised in the United States during the 1970s and, after this, their use soon began to expand across the globe (see chapter two). What are options and warrants? Before addressing this question, a caveat is necessary to specify the slight differences between the two instruments. Options and warrants are very similar in their logic. But, warrants are guaranteed by the very same company issuing the underlying stock rather than by the exchange – as it is the case for stock options. Apart for this aspect, the rationale of the two instruments is the same. Hence, except for specific cases, this thesis will refer primarily to options.²²

An option is a contract which gives the buyer the right, but not the obligation, to buy (*call option*) or sell (*put option*) an underlying asset at a specified price on or before a certain date. Call and put options which can be exercised before expiration are called *American options*. On the contrary, those instruments which can only be exercised at maturity date are instead known as *European options*.²³ As it might be clear, there are four participants in the market for options: buyers and sellers of call options; similarly, buyers and sellers of put options. Buyers of both types of options are often known as *holders*, whereas the sellers are called *writers*. To keep the option open until expiration, holders are required to pay a *premium* to the option brokers (writers). Let us focus on how options work through the example of a stock option.²⁴ The historical and theoretical importance of options will be further

²²However, it is important to notice that, compared to warrants, options are issued on many other underlying referents than just corporate stocks. For this reason, more complex warrants products exist which are known as covered warrants. These are an evolution of warrants in four respects. First, covered warrants can be issued on a wide range of underlying assets. Second, covered warrants are issued by financial institutes and not by the underlying company. Third, covered warrants have different exercise prices depending on the conditions stated by each issuance. Fourth, whilst warrants allow the holder only to buy the underlying, covered warrants allow the holder to buy (call) or sell (put) the underlying. This makes covered warrants more similar to options. But, contrary to the latter, covered warrants do not normally involve the actual delivery of the underlying asset.

²³Note that both adjectives have nothing to do with their geographic meaning.

²⁴The example is adapted from <http://www.investopedia.com/university/options> [accessed on December 30, 2012]. The web site is a major provider of information on financial literacy and

specified in chapter two.

Let us imagine that Sarah wants to buy a call option (the right to buy) on XYZ Inc. shares. In this case, Sarah is a holder of a call option, therefore in a long position. At the moment in which she decides to enter the contract, the share price of XYZ Inc. is 67 dollars, whereas the premium (the price to pay) for a ‘July 70 Call’ is \$3.15. In this case, ‘July 70’ means that the expiration of the contract will occur on the third Friday of July, whilst the *strike price* is \$70. The strike price is the price the XYZ shares has to reach before the call option can be exercised before expiration. As long as the share price is below 70 dollars, the option is said to be *out of the money*. If the share price goes up 70 dollars is instead *in the money*. Between 70 dollars and 73.15 dollars (3.15 being the premium paid to buy the call option), the option is technically considered to be *at the money*. The difference between the amount by which the option is in the money and the strike price is known as the *intrinsic value* of the call options. If the price of XYZ shares remains below the strike price, Sarah is entitled not to exercise the option. But, in this case, she would lose the premium.

Let us notice that a stock option gives the right to control 100 shares with a single contract. As already mentioned, this benefit is known as leverage. Doing the simple maths, the premium is \$3.15 multiplied by 100 equals \$315. As we have seen, the strike price is 70 dollars, which means that the stock price must go above the *break-even price* of \$73.15 – the strike price is \$70 plus \$3.15 which is the premium per share – in order for the call option to have some intrinsic value. Hence, as far as the XYZ Inc. share is quoted at 67, Sarah is down by \$315. Finally, after three weeks the share price is \$78 – an option intrinsic value of \$8 above the strike price of 70. Similarly, the option premium has gone up in parallel to the share and it is now worth \$8.25 multiplied by 100 shares equals \$825.²⁵ Once Sarah subtracts the \$315 she has initially paid for the contract, she has profited of \$510. Hence, she decides to close out the position and take the gains.²⁶

stock-market simulation. Financial literacy is a growing economic sector that aims at educating the investing public. For a critique of financial literacy, see Martin (2002) and also Erturk et al. (2007). For more data on financial literacy, see also the OECD-sponsored International Gateway for Financial Education at <http://www.financial-education.org> [accessed on December 30, 2012].

²⁵The intrinsic value is \$8 plus an hypothetical 0.25 of time value, which is the probability of the option to increase in value.

²⁶From being an option holder, Sarah turns into a writer of options at the moment in which she trades out the option. The opposite happens to the broker/market maker.

What is the rationale behind Sarah's actions? In similar ways to futures, investors use options either to speculate or hedge. In this regard, options present even more trading strategies compared to futures. Sarah is obviously a speculator who assumes a high risk in return for high profit potentials. She correctly anticipated the direction of the stock's movement, its magnitude and the timing. She speculated with options to benefit from these instruments' great leverage. In fact, by controlling one hundred shares with one single option contract, a minor price movement in the underlying is enough to generate substantial profits.

For what concerns hedging instead, options allow to insure against stock-price volatility. The classical example of *protective put* strategy involves the opposite of a call option: put option. Let us imagine that Sarah invested in XYZ Inc. shares but she is worried about a decline in price. Hence, to protect herself, she buys a put option on XYZ shares which gives the right to *sell* such shares at a specific strike price. In other words, the put option increases its intrinsic value the more the underlying shares fall below the strike price. This strategy allows Sarah to offset the losses in the underlying shares with the gains in the put option. There is a risk in this strategy which is called *basis risk*. This is the possibility that the two offsetting investments are not perfectly correlated. In this case, Sarah's strategy presents risk in terms of both potential losses or gains in excess.

Swaps

Swaps are by far the largest traded derivatives. Such instruments involve two parties owning two different financial assets and exchanging the cash flows deriving from them. Most notably, one of the first swaps was introduced in 1981 with an agreement between IBM and the International Bank for Reconstruction and Development (World Bank Group). The latter 'swapped' its US dollar-denominated payments with IBM, in exchange for assuming IBM's obligations which were denominated in Swiss francs and Deutsche marks (Kapur, Lewis and Webb, 1997, 1035). Since then, the use of swaps grew dramatically in particular on two assets: interest rates (interest rate swaps) and foreign exchange (currency swaps). Other important types of swaps refer instead to credit events (credit default swaps, or CDSs) and corporate shares

(equity swaps).²⁷ In order to explain the basic mechanics of swaps, let us focus on a general example of *fixed-for-floating* interest rate swap with the same currency.²⁸

In a fixed-for-floating interest rate swap, a company agrees to pay cash flows equal to a pre-determined fixed interest rate on a *notional principal amount* for a given period of time. In return, it receives a floating interest rate on the same notional principal amount and for the same time period. The notional principal amount is not actually exchanged, but only the cash flows which derive from it. In most cases, the floating interest rate is based either on the London Interbank Offered Rate (LIBOR) or the Euro Interbank Offered Rate (EURIBOR), the rates at which banks are prepared to borrow funds from other banks in the London interbank market and in the Euro area.²⁹ Why would two companies enter into such a swap? The conventional argument is based on the theory of comparative advantages.

For instance, AAA company and BBB company have commercial needs which lead both to borrow funds. AAA is able to borrow cheaply than BBB at either fixed or floating interest rate, but has a greater comparative advantage in fixed interest rate. However, AAA would prefer borrowing at a floating interest rate. On the contrary, BBB prefers fixed interest rate but, due to circumstances such as the company's lower credit rating, such fixed rate is not as attractive as the floating one. To sum up the hypothetical scenario:

- AAA can raise fixed-rate funds at 7% or floating at the LIBOR rate. AAA prefers floating interest rate, but has a comparative advantage on fixed interest rate borrowing.
- BBB has to pay a fixed interest rate of 10%, whilst can borrow floating at the

²⁷Chapter four explains the logic of equity swaps in relation to the case of FIAT. For what concerns CDSs instead, these are contracts in which the seller agrees to compensate the buyer in case of a loan default or other credit events. The buyer pays the *CDS spread* to the seller and receives a pay-off when credit events occur.

²⁸Swaps are OTC instruments the nature of which is highly customisable. For this reason, there are several variations of interest rate swaps (e.g. fixed-for floating, floating-for-fixed, and so on. The example is based on Hull (2009, chapter 7) and Valdez (2007, chapter 14).

²⁹LIBOR is an average measure of the interest rates (one-month, two-months, six-months, one-year, etc.) charged by leading banks in London when lending to other banks. It is set by the British Bankers' Association at 11am and represents a benchmark for global finance. In fact, financial institutions, mortgage lenders and credit card issuers track the LIBOR rate to fix their own interest rates a notch higher than the LIBOR. About LIBOR, see <http://www.bbalibor.com> [accessed on December 30, 2012]. Similar to LIBOR, EURIBOR is based on the average interest rates at which banks lend to each other in the Eurozone. See <http://www.euribor-ebf.eu/euribor-ebf-eu/about-us.html> [accessed on December 30, 2012].

LIBOR rate + 1%. BBB company prefers fixed interest rate, but the floating rate is cheaper than the fixed one.

Hence, AAA raises funds from its lender at 7% fixed interest rate, whilst BBB borrows from its lender at a floating rate equals to the LIBOR rate + 1 %.

However, both companies decide to enter into an interest rate swap on a given notional principal amount – which will not be exchanged – and for a given period of time.³⁰ The terms of such swap agreement are the following:

- AAA agrees to pay BBB the floating rate which equals to the LIBOR rate.
- BBB agrees to pay, let us suppose, 8% fixed interest rate to AAA.

In other words, the swap allows:

- AAA to pay 7% fixed interest rate to its lender, but the company receives 8% fixed interest rate from BBB. This is a profit of 1% which in actual terms makes AAA pay BBB the LIBOR rate - 1% – even less than what AAA would pay if the company borrowed funds directly with at a floating interest rate.
- BBB pays LIBOR rate + 1% to its lender, but receives the LIBOR rate from AAA. This is a cost of 1% which adds up to the 8% fixed interest rate BBB pays to AAA, for a total of 9% fixed interest rate. This last rate is still less than the 10% fixed interest rate BBB was required to pay if the company had borrowed funds directly at a fixed rate.

The example above is simplified to the extent that it does not take into account of differences in interest rates which are in reality of a few basis points. More importantly, this simplified case does not consider the fundamental role of financial intermediaries. In reality, two non-financial companies such as AAA and BBB do not contact each other directly to arrange the swap, but each deal with a swap dealer (banks or other financial institutions). The swap dealer has two distinct legal agreements – one with AAA and the other one with BBB – and charges a fee on the two offsetting transactions. This fee partly compensates the financial intermediary for the risk that one of the two companies could default on the swap payments.

³⁰It is important to note that the swap contract is distinct from the respective contracts in which the two companies previously enter into. In other words, AAA still pays its fixed interest rate of 7% and BBB pays LIBOR + 1%.

Furthermore, since it is unlikely that two companies would contact the financial intermediary at the same time and with opposite needs on the same asset type, many large intermediaries act as market makers. In other words, they post bids and offers at which they are willing to enter into a swap without having another offsetting swap. In so doing, market makers are not only exposed to counterparty risk but also interest rate risk. In this regard, swap dealers have to correctly quantify and hedge the risk accordingly.

In conclusions, as the mainstream narrative suggests, the swap market makes possible for both parties to borrow and repay at the globally lowest costs in interest rate structure and currency. Swaps arguably represent potential positive-sum transactions due to the fact that both parties gain by trading.

Securitisation and asset-backed securities

Forwards, futures, options and swaps are the four basic derivatives instruments. Before concluding this introduction, it is important to look at the practice of *securitisation*. The latter is not a derivative instrument per se, but indicates the process of transforming illiquid assets such as bank loans into securities that can be traded on financial markets.³¹ The synergies between securitisation and derivatives emerged for the first time in the 1970, when the Government National Mortgage Association (Ginnie Mae) created asset-backed securities that referred specifically to mortgages (Markham, 2002*c*, 50). Known as mortgage-backed securities (MBSs), these instruments revealed a derivative component. In fact, once the income streams – such as the payments that the home-owner gives to the mortgage originator – are repackaged into a security and then sold to third parties on secondary markets, the value of such security partly derives from the repayments made by the home-owner on its mortgage. Let us see how ABSs work in practice in order to appreciate the complex dynamics of securitisation and derivatives.³²

Like ordinary bonds, ABSs pay the holder a series of coupons at set maturities for an amount calculated on the basis of either fixed or variable interest rates. However,

³¹American banks pioneered the securitisation of both asset and liabilities in their balance sheets through the creation of the call loans market and the introduction of certificates of deposits. See Konings (2006).

³²The following example concerning asset-backed securities is based on <http://www.borsaitaliana.it/notizie/sotto-la-lente/assetbackedsecurities.htm> [accessed on December 30, 2012].

contrary to ordinary bonds, ABSs are securitised products. What does it entail? Imagine that a bank holds in its balance sheet a series of loans given to clients in various forms – mortgages, automobile purchase loans, student loans, credit card payments, and so on – and needs more liquidity. In order to increase liquidity, the bank converts the receivable on these loans – which are the instalments paid by clients on their loans opened with the bank – through securitisation. The latter is the process through which the bank sets up a company known as special purpose vehicle (SPV) that buys from the bank the receivables and the respective collaterals – for instance, the rights over the mortgaged houses, cars, etc. Then, the SPV company pools the various types of receivables into ABSs and sells them with a nominal value lower than the receivables. In so doing, the SPV company uses the difference to pay the ABS coupons.

In other words, the creation of ABSs through securitisation is the process through which the bank removes a series of loans from its balance sheet, pools these tranches in appropriate products and assigns them – together with the income streams they generate – to the market via the SPV company. This is done in order to increase liquidity and advancing more loans. However, as the case of the recent subprime crisis showed, this process contains several elements of risk. For instance, the coupons on ABSs might not be repaid in the event of inability to collect the receivables from the borrowers. For this reason, regulation usually imposes minimum requirements that ABSs must satisfy before being listed on the market. These requirements are for instance an adequate market circulation or a minimum rating between AAA and BBB from credit-rating agencies – itself a very controversial aspect of the 2007 subprime crisis.

The ABS dimension is vast and includes many sub-categories and payment complexities. Residential MBSs are by far the largest-traded type of ABSs. Since the mid-1980s, a particular type of MBSs was introduced that came to be known as collateralised mortgage obligations or, more simply, CMOs (Markham, 2002*c*, 143-144). These instruments split payments to holders into different ‘tranches’ according to maturity and risk. The well-known collateralised debt obligations (CDOs) are similar to CMOs but pool together also wholesale or corporate loans.

Conclusions

This technical excursus into derivatives markets, instruments and actors has provided a primer on this complex topic. To begin with, the analysis has outlined the main types of derivatives, their underlying referents and the markets where these instruments are traded. Successively, it has studied the basic logic of forwards and particularly futures. After this, the third section has explained the rationale behind the use of futures and derivatives, identifying the broad categories of market participants. Then, the primer has examined the other basic types of derivatives such as options and swaps. Finally, the last section has concluded with an example of asset-backed securities, showing the important connection between derivatives-based techniques and securitisation.

It is now time to start our enquiry into the political economy of financial derivatives and their significance in the Italian context. The next chapter reviews the insights of the financialisation literature and their inability to capture the institutional and discursive specificities of finance-driven capitalism across different societies. In this regard, the analysis rethinks the financialisation debate from the vantage point of the agency-centred approach.

Chapter 1

Accounting for the distinct traits of financialisation

The financialisation debate provides an important intellectual terrain for scholars of diverse theoretical and disciplinary backgrounds. By exploring the growing significance of finance in modern societies, it represents an invaluable resource to examine derivatives markets and instruments from a critical stand point. However, whilst the literature is particularly attentive to the institutions and discourses of Anglo-American economies, its insights are too general for what concerns financialisation elsewhere (Engelen, Konings and Fernandez, 2010, 57). As a result, it finds itself in an uneasy position when it comes to explore the modalities through which other societies experience financialisation, as well as to what extent they reveal features which are context-specific.

This chapter reviews the main contributions to the financialisation debate and presents the following central claim: the literature underplays the differential trajectories of financialisation due to a view on financial phenomena from the perspective of structural power. Scholars tend to describe the institutions and discourses of financialisation as structures which are permeated by the power of finance. In other words, power is entrenched and perpetuated in the structures of society, producing an analytical scenario where it is difficult to articulate agency in an active sense. Except for moments of crisis, agents simply conform to semi-systemic requirements and relinquish their political-economic resources. This impasse prevents the literature from appreciating the actors who adapt the institutions and discourses of

financialisation differentially and why they construct them through power struggles. In the end, without an enquiry into the dimension of agency, financialisation appears as a process which diffuses homogeneously.

Considering this, the chapter puts forward an agency-centred approach to account for financialisation and its differential projections outside the Anglo-American heartland. This means rethinking power from the vantage point of agency in order to appreciate how our social reality does not entail an agent-structure dualism, but an agent-agent interaction which is mediated by continuously renegotiated institutions and discourses. In this context, actors exert power when they strategically manipulate institutional and discursive architectures in the attempt to leverage their actions vis-à-vis other actors. Whilst some agents wield power by establishing new structures, others make sense of the latter in their own terms, often innovating the very same imperatives they were initially constrained by (Knafo, 2010, 503-504). These dynamics of agential interaction, agential power, institutional and discursive mediation provide the historically sensitive scenario where to appreciate how and why derivatives-based risk management emerged in Italy and in which sense this innovation shows distinct traits.

The analysis is outlined in two main sections. First, the financialisation debate is introduced according to four theoretical streams: Régulation school together with post-Keynesian economics; Marxist political economy; Foucauldian political economy. As it is shown, this literature thoroughly explores the formal and informal institutions in the US and the UK, but draws at most general conclusions about financialisation elsewhere. This inattention to the differential trajectories of financialised phenomena prevents the four approaches from accurately analysing the specificities of derivatives – and other practices of financialisation – outside the Anglo-American scenario. The second section shows that the problem concerning the distinct traits of financialisation results from the literature’s reading of finance through the lenses of structural power. Against this, the section introduces the conceptual apparatus of the agency-centred approach.

1.1 The debate on financialisation

The literature on financialisation has two merits. First, it challenges the assumptions of mainstream economics concerning the informational efficiency of financial markets (Fama, 1970). Against this, financialisation studies emphasise instead the crisis-prone and exploitative nature of modern finance. Second, and this is a fundamental aspect for critical scholarship, the financialisation literature avoids conceptualising financial phenomena as market forces which ‘disembed’ from the socio-political institutions of the Bretton Woods period.³³ The practices of financialisation are instead seen as created through dense institutional and discursive architectures permeating the fabric of society (Konings, 2008*b*, 256). At this point, however, it is logic to ask a preliminary question: what is financialisation?

Admittedly, this is an ill-defined concept through which scholars sum up a diversity of research themes and theoretical stances.³⁴ Two definitions of financialisation are commonly adopted. First, Greta R. Krippner (2005, 174-175) builds on the seminal study *The Long Twentieth Century* by Giovanni Arrighi (1994) and describes financialisation as “a pattern of accumulation in which profits accrue primarily through financial channels rather than through trade and commodity production.” The adjective ‘financial’ refers to those operations transferring capital in

³³The idea of market ‘(dis-)embeddedness’ is widely adopted in political economy. Karl Polanyi (1944) used this concept to describe the biological tension existing between the market economy and the necessity to embed land, labour and money within mechanisms of socio-cultural and political protection. According to Polanyi, land, labour and money are fundamental to human reproduction and cannot be traded on the market as any other commodity. If this occurs, then the market would be disembedded and humanity could face decay. This narrative gives a clear-cut story about the complex interaction between state, market and community in modern capitalism. Yet, it is often misinterpreted as if market forces – once fully disembedded – were no longer upheld by political and socio-cultural institutions (Konings, 2007). See Krippner (2002) for a similar critique of embeddedness in economic sociology (Granovetter, 1985).

³⁴It is possible to summarise some of the theoretical contributions to the financialisation debate in the following way: post-Keynesian economics (Stockhammer, 2008; Palley, 2010); Miskyian institutionalism (Nesvetailova, 2007; Toporowski, 2000); régulation school (Boyer, 2000; Aglietta and Breton, 2001); social structure of accumulation (Duménil and Lévy, 2005; Kotz, 2011); Foucauldian political economy (De Goede, 2004; Langley, 2009); critical management and accounting studies (Erturk et al., 2008; Froud et al., 2000); economic geography (Aalbers, 2008; Leyshon and Thrift, 2007); economic sociology (Krippner, 2005); social studies of finance (Knorr-Cetina and Preda, 2006; MacKenzie and Millo, 2003); neo-Gramscianism (Macartney, 2011); world-systems theory (Arrighi, 1994); Marxist political economy (Bryan and Rafferty, 2006*a*; Lapavistas, 2009*b*). For an overview on financialisation, see also the special issues of: *Economy and Society*, Vol. 29, No. 1, February 2000; *Competition and Change*, Vol. 12, No. 2, June 2008; *Competition and Change*, Vol. 13, No. 2, June 2009.

the expectation of future interest, dividends, or capital increase. Hence, Krippner advances an ‘accumulation-centred’ interpretation of financialisation by focusing on how and where profits are generated. In so doing, she shows that the American economy has grown primarily through financial activities since the 1970s. Most notably, she demonstrates that manufacturing definitely declined as of the mid-1990s, whilst the FIRE sectors (Finance, Insurance, Real Estate) became the primary source of total corporate profits. What is more, Krippner shows that the sources of revenue for non-financial companies shifted dramatically in favour of portfolio income – that is interest payments, dividends, and capital gains on investment (Krippner, 2005, 179, 185).

In spite of such thorough empirics, Krippner’s definition excludes any other economic, social, political and cultural facets of financialisation. For this reason, a second most cited definition was advanced by Gerald A. Epstein (2005, 3) who describes financialisation as “the increasing role of financial motives, financial markets, financial actors and financial institutions in the operation of the domestic and international economies.” Certainly, this definition is general enough to include not only the dimension of corporate profit, but also the infinite complexities in which modern societies experience the phenomena in question. Premised on this, the next three subsections review some amongst the main contributions which shed light on the multi-faceted character of financialisation. First, Régulationists and post-Keynesian economists present accurate studies about the impact of financialisation on the components of the aggregate demand. Second, Marxist political economists investigate the modalities of financial expropriation from labour. Finally, Foucauldian political economists reconstruct how a veil of scientific technicalities depoliticise the practices of financialisation.³⁵ As it is shown, these three approaches focus extensively

³⁵Two aspects brought this thesis to focus on the above-mentioned approaches. First, they represent the most consolidated research traditions in the financialisation debate. Second, including other works would have exceeded the scope of this project. In any case, it is important to specify that other studies – except the most recent stream of research on the differential trajectories of financialisation (see introduction and section 1.2) – have been similarly inattentive to financial expansion outside the Anglo-American space. Of course, this thesis does not claim that this inattention is always due to an excessive reliance on structural power. For instance, this is not the case for several works in social studies of finance – see e.g. Beunza and Stark (2004), MacKenzie (2006), Zaloom (2006) or Preda (2009). In fact, these works are not primarily concerned with showing how the power of finance is entrenched and replicated in socio-economic structures. Their aim is rather to observe the micro-level functioning of financial markets to uncover the socio-cultural embeddedness of models and technologies. Building bridges between the agency-centred approach and social studies of finance would provide opportunities for productive research.

on the Anglo-American economies as the most advanced spaces of financialisation. Yet, scholars do not give sufficient attention to other societies, implicitly assuming that the phenomena they describe unfold across the Western world more or less homogeneously.

1.1.1 The macroeconomics of financialisation

In recent years, Régulation school's exponents Michel Aglietta and Robert Boyer have placed great emphasis on financialisation as an unstable regime of growth after the crisis of Fordism.³⁶ This research overlaps with post-Keynesian studies advanced by Engelbert Stockhammer (2008) and Thomas I. Palley (2010). In fact, both schools focus on the return of *rentier* finance as an unstable solution to an aggregate demand drastically weakened by wage deflation.³⁷ The *rentier* sector is the main driver of financialisation in the United States and other advanced economies, the consequences of which dramatically impact on less developed countries (Duménil and Lévy, 2005). *Rentier* policies distort the well-regulated form of capitalism which Western societies experienced during the Bretton Woods period. How did this scenario come about?

In the 1960s, growing labour militancy unravelled the capital-labour compromise which formed the core of Fordism (Glyn and Sutcliffe, 1972).³⁸ From the 1970s

³⁶Fordism was a mode of development emerged in the American industrialisation (Aglietta, 2002). It entailed an organisation of business which – on the basis of Taylor's scientific management – pushed even further the division of labour into separate tasks, dramatically mechanised the production processes, and separated the managerial functions from shopfloor operations. This system of mass production based on the intense use of specialised machinery led to high productivity growth and economies of scale. Accordingly, employees obtained shares of productivity gains through the indexation of their salaries. The latter defined the essence of the fordist capital-labour agreement, a dimension which was supported by compatible institutional forms such as oligopolistic inter-firm competition, welfare state and demand management policies, as well as the Bretton Woods international monetary system with its mechanisms of capital controls (Boyer and Sailard, 2002, 338). After World War II, many countries in the Western hemisphere emulated Fordism, although maintaining substantial degrees of diversity in terms of growth and welfare provisions (Lipietz, 1987, 40).

³⁷Keynes (1936) used the notion of *rentier* to describe finance as a parasitical group which profits on the scarcity of capital, often subtracting fundamental productive resources. Keynes argued in favour of the 'euthanasia of the *rentier*' through policies of low interest rates (Lapavistas, 2010, 11).

³⁸The crisis of Fordism is subject to a controversial debate after the publication of *The Economics of Global Turbulence* by Robert Brenner (2006). Against the above-mentioned 'supply-side' interpretation, which emphasises labour militancy, Brenner argues that it was the uneven development amongst Western political economies which eventually generated a cut-throat competition amongst the US, Germany and Japan. This historical conjuncture overfilled global markets with too many producers and goods (overcapacity), leading to an inexorable decline in the rate of

onwards, capital counteracted this tendency by attacking labour protections and public services. As a result, the social product began to be redistributed in favour of the upper-income managers and profit-recipients. However, this process had a limit: subtracting purchasing power from the vast majority of people implied the erosion of the mass-consumption society. For this reason, the *rentier* sector was empowered and advanced financialisation as the alternative solution. In fact, finance began sustaining the aggregate demand – both in terms of consumption and investment – through substantial household borrowing and the inflation of asset prices. In so doing, the reproduction of an otherwise stagnating regime was guaranteed, although in a manner which is prone to financial instability (Palley, 2010).

In the light of this historical transformation of capitalism, Régulationists have examined the macroeconomics of financialisation. Aglietta together with Régis Breton (2001, 434) emblematically describe the essential role of finance in modern capitalism in the following manner:

[...] critical to the emerging pattern of business cycles is asset price inflation, rather than inflation in the goods markets. Likewise, downturns can now result from deterioration of confidence in the equity market, rather than being necessarily triggered by a recessive shift in monetary policy. In these new dynamics, the interaction between speculative bubbles in asset markets, rapid credit growth, over-investment and financial imbalances become all-important.

Boyer (2000) has taken the issue one step forward by modelling the functioning of a regime of growth and a mode of regulation driven by financial imperatives.³⁹ In an influential article entitled ‘Is a Finance-led Growth Regime a Viable Alternative to Fordism? A Preliminary Analysis’, he argues that giant mergers, global capital mobility, shareholder pressures on corporate governance, as well as the expansion of equity culture amongst vast segments of the population strongly suggest the emergence of such a new mode of development.

profit. Furthermore, Western governments have thus far been unable to solve the global economic overcapacity, opting instead for palliative policies – such as exchange-rate manipulation – which have kept uncompetitive high-cost producers in business. See the ‘Symposium on Brenner and the Global Economic Crisis’, *Historical Materialism*, Vol. 4, No. 1, 1999; Vol. 5, No. 1, 1999; and also Arrighi (2003), Konings (2005) and Brenner (2005).

³⁹Stockhammer (2008) has also developed a similar study, comparing American and European data on consumption, investments, government spending and net exports.

The overall macroeconomic model is centred around an expanding stock market which sustains both firms' investment (supply-side) and consumption patterns (demand-side). On the one hand, production undergoes a general reorientation of management techniques, degree of specialisation and industrial relations in line with the primacy of shareholder profit. On the other hand, wage earners have access to financial gains – direct equity holdings, pension funds, or credit consumption – to compensate the decline in wage levels due to job market flexibility.⁴⁰ The prospect of gains on the financial markets has a direct influence on the decision to save or consume, a behaviour identified as 'patrimonial equity-based' household. Finally, this model implies a redefinition of fiscal and monetary policies. Governments render the national economy more competitive by restraining public borrowing and expenditure. Central bank intervention should instead target price stability to regulate financial speculation, rather than aiming at the best mix between inflation and growth as it was the case during Fordism.

Is there any preliminary evidence about this finance-led macroeconomy? Let us start from the production side of the model, that is the maximisation of shareholder value. As Robert Guttman (2008, 3-4) shows, institutional investors such as pension funds, mutual funds, hedge funds, private equity funds are the primary corporate shareholders in Western markets. These actors advocate a rationale based on the necessity to improve the quarterly earnings per share, instead of preferring long-term productive activities and investment in capital goods.⁴¹ In this context, the share price and the capacity to inflate it – hence, demonstrating the market 'confidence' for that particular company – is the central concern for corporate governance. Indeed, a company is evaluated on the basis of its share price and its ability to generate higher dividends in the short-term. But, in the absence of long-term investment which could secure bigger market shares through higher productivity and lower prices, it is fundamental to find different growth channels to boost share prices.

⁴⁰Under Fordism, employees obtained shares of productivity gains through the indexation of their salaries. According to the formula, wages increased with productivity plus the change in the consumer price index (inflation rate). Such a wage indexation bound together the increase in national productivity and the consumers' purchasing power, avoiding a crisis of overproduction. On the 1948 and 1950 agreements between General Motors and United Auto Workers, see Harbison (1950).

⁴¹Stockhammer (2006) describes this aspect as the 'decoupling' of productive investment and corporate profits. Whilst the latter was relatively restored since the crisis of 1970s, the former steadily declined in favour of financial investment.

Such necessity would explain the phenomenon of mergers and acquisitions amongst corporations as particularly experienced from the 1980s onwards.

For what concerns instead private consumption behaviours, these were characterised by spectacular dynamics of ‘wealth effect’ during the 1990s (Onaran, Stockhammer and Grafl, 2011). Particularly, top income and middle income groups increased their consumption patterns due to a greater financial wealth accumulated during the dot-com bubble – conversely, saving rates declined substantially. Once this ended in 2000, consumption surprisingly maintained the same levels. This time, booming house prices rather than financial assets supported the marginal propensity to consume, with residential ownership being considered as an excellent collateral for debts.⁴² In general terms, households had more access to credit not only through mortgages, but especially consumer credit, credit cards and overdraft bank accounts (Stockhammer, 2008, 188).

In sum, the decline of Fordism led to the empowerment of *rentier* finance and the financialisation of Anglo-American economies. This generated fragile patterns of production, distribution and consumption. Against this unstable macroeconomic system, Régulationists and post-Keynesian economists put their empirically sound research at the service of a laudable policy agenda. They suggest that policies should aim at redistributing national income more equally (Palley, 2010). Furthermore, investments should be channelled towards sustainable technologies (Courvisanos, 2012). Last but not least, the financial sector should be segmented in two distinct commercial and investment spheres, whilst the international financial architecture should be reorganised on the basis of capital controls and equilibrium in the balance of payments (Crotty, 2000; Crotty and Epstein, 2008).

However, in spite of this important research, Régulationists and post-Keynesian economists fall short of properly accounting for *why* differential trajectories of financialisation exist. To be sure, Boyer opens up to further studies on the varieties of finance-led growth regime across different national economies.⁴³ Yet, this effort necessitates of important corrections in order to capture the historical reasons upholding these regimes. Without such modifications, the analysis would merely map

⁴²Of course, other aspects sustained the economic cycle such as: low interest rate by the Federal Reserve and China’s buying up American debt; the Bush administration’s military expenditure for the war on terror (Bellofiore, Garibaldo and Halevi, 2011, 125-126).

⁴³Similarly, Stockhammer (2008) provides an interesting study about the functioning of finance-dominated accumulation in Europe.

how they differ on the basis of macroeconomic performances and locked-in institutional configurations. Let us elaborate more on this point.

Régulationists and post-Keynesian economists emphasise systemic regularities. This implies that the finance-led regime is created at a critical juncture in the past and breaks up at a new one in the future. Their macroeconomic analysis focuses on the period between the two extremes, when institutions are consolidated in their structural form and the system can be analysed in its general laws. This search for regularities is problematic because it obscures the agents who constantly create, reflect upon and innovate institutions in any given historical moment. These political-economic dynamics are temporarily suspended and then brought back in the analytical picture during moments of systemic crisis. At this point, the regular motion of the system may be transformed into something different.

Boyer (2000, 142) himself recognises that his model provides only “a cognitive map and a simple representation of a highly complex process.” In fact, in order to make sense of real-world complexities, he switches from an axiomatic to a descriptive register.⁴⁴ However, in spite of this descriptive turn, Boyer does not move beyond the methodological nationalism which characterises Régulation school and post-Keynesian economics alike. Indeed, by remaining within the boundaries of the national economy as the analytical unit, he suggests that decision-makers outside the US and the UK could be enticed to import the core institutions of an ‘equity-based economy’ on the assumptions that their countries would gain greater economic returns.⁴⁵ In this regard, Boyer (2000, 143) concludes that the finance-led growth regime would be adapted through phenomena of ‘hybridisation’. This means that different hybrid forms would emerge according to national path dependencies and the ability of policy-makers to implement the best institutional configuration at the domestic level.

⁴⁴In an interesting study about the European case, Stockhammer (2008, 186) also switches from a macroeconomic analysis (regime of accumulation) to a descriptive study about the institutional environment upholding the macroeconomics (neoliberal mode of regulation). In this regard, Stockhammer points out that “financialization [...] is the outcome of policies [...] In particular, financial deregulation in European countries [...] is strongly shaped by the particular (neo-liberal) path of European integration.”

⁴⁵Boyer (2000, 143) considers this idea as fallacious for two intertwined reasons. First, due to their market-based nature, Anglo-American economies are able to benefit the most from the finance-led growth. Second, the institutions of the finance-led regime are path-dependent, meaning that policy-makers outside the US and the UK would find difficult to adopt them in the same way as they function in their native context.

Implicitly, in the attempt to explain the global implications of the finance-led regime, Boyer cross-fertilises his analysis with the rational-choice stream of research on varieties of capitalism (Hall and Soskice, 2001).⁴⁶ Here, national policy-makers calibrate domestic institutions – such as industrial relations, corporate governance, inter-firm relations and vocational training – to reach an equilibrium point which maximises the country’s competitive stance in the global economy. The end result would be that all national models of finance-led regime would differ on the basis of their respective path-dependent institutional configurations. However, this cross-fertilisation is an uneasy route. To begin with, it assumes a priori the intentions of policy-makers whose rational actions aim exclusively at enhancing the institutional competitive advantages of their nations. In so doing, it ignores the accidental, unplanned and unrepeatable circumstances which lead elites to develop, adapt and renegotiate the institutions of financialisation.⁴⁷ Furthermore, articulating the differential trajectories of finance-led regime through the lenses of path-dependency is an exercise of ‘comparative statics’ that captures institutional diversity as fixed structures (Streeck, 2010, 660-662). However, the analysis disregards the continuous modalities through which actors construct distinct institutions and discourses and why they do so.⁴⁸

To conclude, although Régulation school and post-Keynesian economics open up

⁴⁶The literature on varieties of capitalism questions orthodox assumptions concerning market universality and the convergence of all societies towards the Anglo-American model. Scholars empirically demonstrate a reality of international divergence, in which the different patterns of national growth remain anchored to path-dependent trajectories. Such divergence is due to different institutional configurations through which national models were historically constructed. In other words, echoing Polanyi (1944), each national model reflects a variety of combinations amongst market-exchange, state authority and communal ties in specific institutional domains. The literature presents also a theory of institutional comparative advantages together with the empirical research on the diversity of capitalist societies. The latter identifies the perfect configuration for policy-makers to render national models of capitalism competitive in the international scenario. For an overview on varieties of capitalism – from the rational choice-based studies to the historically oriented ones – see Hall and Soskice (2001), Coates (2002), Streeck and Thelen (2005). For a comparison between Régulation school and the research programme on varieties of capitalism, see Boyer (2005).

⁴⁷In fact, as chapter three and four show, Italian neoliberal-minded actors barely considered greater economic returns and national competitive advantages in formulating the actions which financialised important segments of Italian capitalism. These decisions were instead taken to hybridise the country’s institutional environment and eradicate conservative political-economic forces (Dyson and Featherstone, 1996; Deeg, 2005*a, b*).

⁴⁸The tendency to understand institutional diversity in static terms is a problem which afflicts also the research advanced by Engelen, Konings and Fernandez (2010). See introduction and section 1.2.

to the possibility of researching on the differential trajectories of finance-led growth, they fall short of properly accounting for the historical reasons why diversity exists. The approach is limited to mapping how national economies differ on the basis of fixed institutional configurations and macroeconomic regularities. In so doing, it fails to develop a historically sensitive enquiry into the specific origins and unintended evolution of institutions and discourses.

The next subsection reviews two important contributions on financialisation from the vantage point of Marxist political economy. First, Costas Lapavitsas shows how a new historical configuration between finance and industrial capital created new forms of *financial expropriation* from workers. Second, Bryan and Rafferty – in collaboration with Randy Martin – focus the attention on how the expansion of financial derivatives rethinks the two dimensions of capital and labour. As it is shown, Marxists go beyond themes such as income inequality and weak investment growth, emphasising instead financialisation as a new form of labour exploitation.

1.1.2 Financialisation and the exploitation of labour

Lapavitsas (2009*b,a*, 2010) examines financialisation as a growing sphere of circulation over production. However, he moves away from the unilateral causality which pervades Marxist studies and also post-Keynesian accounts. Indeed, both schools see financialisation as being caused by either stagnating production or, vice versa, by how *rentier* finance hinders use-value production and income equality. These approaches are problematic since they both fall short of capturing the complex interaction between finance and industrial capital. In reality, causality between these two dimensions occurs both ways simultaneously. As Lapavitsas (2010, 17) explains:

[...] real accumulation shapes the financial system through the trade credit customs and practices of industrial corporations, the replacement of trade by banking credit, the availability of reserves and liquidity for banks, the informational environment of inter-bank lending and so on. Finance, on the other hand, impacts on real accumulation through credit accelerating the turnover of capital, lower money reserves improving enterprise profitability, loans and information opening up new areas of profitability, and so on.

What is more, the relationship between industrial capital and finance capital does not assume an explicit form. It is instead mediated by complex historical, institutional, political, customary and cultural structures. For this reason, Lapavistas directs his attention to this mediation in order to appreciate financialisation as a broad systemic transformation of capitalism during the last four decades. Let us follow his analysis.⁴⁹

During the post-war period, industrial capital relied extensively on retained profits rather than access to banking credit. Furthermore, particularly from the 1960s onwards, corporations increasingly side-stepped banks by resorting to external forms of financing such as bond and equity trading. In other words, industrial capital became at the same time more independent from banks but also more ‘financialised’, to the extent that corporations started to trade financial assets on their own accounts. Considering this process, banks restructured their activities in search for profit towards two main directions: workers’ income and investment banking. These two dimensions explain the dramatic expansion of banking operations during the last three decades.

The attention of banks towards workers is a central dimension of modern finance, as clearly shown by the recent subprime crisis. On the one hand, workers’ borrowing such as mortgages or credit consumption increased dramatically in the face of stagnant real wages. On the other hand, banks and other intermediaries were able to securitise the receivables on such loans, creating new financial markets and products. In so doing, these institutions extracted profit directly from wages and their ability to repay loans, rather than indirectly via the surplus value created by industrial capital. For what concerns investment banking, this entails borrowing in wholesale money markets and investing in securities, earning profits through fees and proprietary trading. Investment banking was boosted by several phenomena since the 1980s, such as waves of mergers and acquisitions, the expansion and deepening of financial markets, as well as the new regulation which reintroduced universal banking in advanced economies. The latter allowed former commercial banks to become huge conglomerates involved in a vast range of financial services. Their operations were accompanied by new practices in information gathering and risk management, itself the result of innovative computational techniques. These replaced the old ‘relational’

⁴⁹The following review is based on Lapavistas (2010, 21-24).

model – based on personal visits and bank fiduciaries – with statistically intensive methods of evaluating clients’ creditworthiness. In many instances, such processes of evaluation were subcontracted to other actors such as credit rating agencies.

Lapavitsas concludes that financialisation is a systemic transformation of modern capitalism, one which renews the mediating structures between real accumulation and finance. This occurs along three specific lines. First, industrial capital increasingly relied on financialised forms of external finance. Second, in response to this, banks shifted their activities towards workers’ income and investment banking. Third, as a result of this, workers became entrenched in the financial system as consumers, savers and pensioners. In the context of stagnant real wages and declining public welfare provisions, finance was able to expropriate profit directly from people’s income by means of securitised lending.

Another important work in Marxist political economy is the research advanced by Bryan and Rafferty (2006*a*) who focus on the unique role of financial derivatives in present-day capitalism.⁵⁰ In ‘Financialization and Marx: Giving Labour and Capital a Financial Makeover’ (2009) – an article co-edited with Martin – they deal with the concept of financialisation by arguing that the latter is affecting both labour and capital in new terms. First, finance reinvents labour as a ‘form of capital’ in itself. Second, capital acquires more fluidity through derivatives, an aspect which intensifies its competitive character. In order to address these two dimensions, Bryan, Martin and Rafferty study the issue from two different angles, namely the labour-related categories of ‘commodity capital’ and ‘variable capital’. The former refers to workers selling their labour power as a commodity in the context of circuits of capital (Marx, 1885, part 1). The latter is instead labour as that component of capital which – in opposition to ‘constant capital’ – “both reproduces the equivalent of its own value,

⁵⁰Bryan and Rafferty have looked at derivatives from different angles. First, they have argued that derivatives represent a ‘third degree’ of separation in the ownership of capital after the joint-stock form. For instance, the holder of a stock option is entitled only to the price movements of the underlying share but not to the company shares themselves (Bryan and Rafferty, 2006*a*). Second, they have contended that derivatives function as floating anchors for a global monetary system which restrains labour’s standards of living (Bryan and Rafferty, 2006*b*). Third, as discussed in the review above, Bryan, Martin and Rafferty (2009) – see also Bryan and Rafferty (2006*a*) – have shown that derivatives and securitisation expand the logic of corporate competition by making possible to value and trade the myriad of corporate micro-assets on the basis of their risk exposures. This process implies growing constraints on labour. Finally, Bryan and Rafferty (2011) have put forward the idea that derivatives expand capital accumulation by deconstructing the surrounding political, socio-economic and environmental reality into smaller elements. These constituents are then commodified and traded on financial markets.

and also produces an excess, a surplus-value” (Marx, 1867, 317). Let us see them in turn.

In terms of labour as commodity entering the circuits of capital, Bryan, Martin and Rafferty (2009, 460-464) argue that financialisation affects this dimension by increasingly enclosing the household as a unit of financial calculation. This phenomenon requires households to identify the types of exposure to financial risk and how to manage them.⁵¹ Indeed, there are many realms of everyday life – such as health insurance, housing, education, portfolio investments, retirement and so on – which, once privatised and marketised, become increasingly exposed to financial risk. In this regard, households would be required to familiarise with the functioning of derivatives as these allow them to hedge their risk exposures.⁵² This financial incursion in the daily lives of people has the effect of reconstituting labour as a form of capital, to the extent that the circuit of individual capital finds validity also for the reproduction of labour itself. How does this transformation unfold?

In the well-known circuit of capital which Marx (1885, part 1) described as:

$$M - C...P...C^1 - M^1$$

money (M) is invested by the capitalist in commodities (C) such as labour power and means of production, the purpose of which is to deploy them in production (P). The result of the production process is a commodity (C^1) which – once sold on the market for a price higher than what paid to the worker as a wage – allows the capitalist to realise surplus value (M^1). The latter returns to the production process in the form of productive investments, as well as to finance capital as money with interest. In spite of describing the circuit of an individual capital, Bryan, Martin and Rafferty (2009, 463-464) show that under financialisation such steps come to depict the very same reproduction of labour power. Indeed, this is dependent on credit – used to buy commodities for the household’s subsistence – in the same way as industrial capital depends on money capital to buy labour force and machineries. Once the wage has been paid to workers, a part of this accrues as interest payments

⁵¹Martin (2002) defines this aspect as ‘the financialisation of daily life’.

⁵²Here, Bryan, Martin and Rafferty refer particularly to the idea of risk management utopia advanced by the behavioural economist Robert Shiller (2003). His company Macromarkets LLC. focuses on the creation of innovative financial instruments to facilitate investment and risk management.

on the money capital initially advanced to households. Hence, what remains of the wage after such interests have been repaid appears as labour's surplus, therefore becoming subject to 'competitive calculations' about what part of the wage is used for subsistence and what part goes to repay the debt.

For what concerns labour as variable capital, the implications brought by financialisation need to be contextualised within capital as the social relation of value in movement. In this regard, Bryan, Martin and Rafferty (2009, 464-468) contend that financialised practices such as securitisation and derivatives expand the logic of corporate competition to the myriad of micro-assets in a given company – those 'bits' of capital such as machinery leasing, mortgages, loans and so on – which can be valued on the basis of their risk exposures; then their performances can be repackaged in derivatives products; and eventually traded on financial markets, where their prices fluctuate according to the performance of the underlying referents as well as the general market sentiment. This expansion of the competitive logic to all the possible corporate micro-assets that can be securitised implies growing constraints on labour as variable capital. The latter is inserted into performance calculations made by companies and remunerated on the basis of real-time market valuations.

Hence, Bryan, Martin and Rafferty conclude that financialisation presents dramatic implications for labour. The everyday-life reproduction of workers is increasingly commodified into a circuit of capital in itself. What is more, within the sphere of production, the growing competitive imperatives amongst corporations – stemming from securitisation and derivatives – reveal a profoundly exploitative attack on labour as variable capital.

To sum up, Marxist political economists present insightful studies concerning the new forms of labour exploitation under financialisation. These works advance new concerns for political resistance, far more radical than the policies put forward by Régulationists and post-Keynesians. In fact, according to Marxists, politics should aim at resisting workers' participation in financial markets and, at the same time, de-commodifying social relations through the provision of collective services such as housing, education, health and pensions (Bryan and Rafferty, 2011, 23). In other words, these services should represent fundamental rights for all human beings.

More importantly for the purposes of this thesis, Marxist studies problematise derivatives in a new light. These instruments are fundamental to financialised cap-

italism in two respects. First, they allow finance capital to extract profit directly from workers' mortgages, credit cards and other forms of loans. Second, derivatives are not only exploitative from the consumption side but also from the vantage point of production. In fact, derivatives intensify capitalist competition – therefore the rate of labour exploitation – by exposing corporate micro-assets to new methods of evaluation on derivatives markets. In so doing, Marxists conceptualise derivatives as more than just tools for hedging efficiency or speculative disarray. In a word, derivatives are *productive* to the extent that they commodify our social reality in a financialised guise and expand the frontiers of global capital accumulation (Bryan and Rafferty, 2011, 3).

However, in spite of such an innovative view on derivatives and financialisation, Marxist political economists disregard the distinct institutional and discursive developments in different societies. Both studies above abstract the inner dynamics of financialised capitalism from the numerous layers of historical specificity. And they do it for a very good reason: to show that the capitalist system is ultimately coherent in oppressing labour emancipation. Marxist scholars may well ask whether it is really necessary to pay attention to the different trajectories of financialisation, when in the end it is still about capitalism unfolding in a highly exploitative manner. This is an important consideration that directly challenges the recent trend to merge financialisation studies with the research on varieties of capitalism (Engelen, Konings and Fernandez, 2010). Yet, it is crucial to recognise that Marxist scholars disregard the differential traits of financialisation across the world for the very same methodological inadequacy which empties agency of its political-economic resources. To say the least, this is problematic for a tradition the aims of which are revolutionary (Kouvelakis, 2003). What does active agency mean?

Section 1.2 examines this issue more in depth. For the time being, suffice it to say that Marxist political economy tends to *reify* the structures of financialisation as having a life of their own, a seemingly objective character which exert power over labour.⁵³ In spite of acknowledging their capitalist-biased nature, these structures are immobilised by opposing the concepts of power and agency (Knafo, 2010, 494).

⁵³As Petrović (1995, 463, my italic) puts it, reification is “the act (or result of the act) of transforming human properties, relations and actions into properties, relations and actions of man-produced things which have become independent (and which are *imagined as originally independent*) of man and govern his life.” For a classical meaning of reification, see Lukács (1972).

The power of capital is structurally entrenched in society, therefore leaving no concrete space of action for agency. In this unrealistic and politically inactive context, those who have structural power (e.g. finance capital) exert no other agency but reproducing the status quo. Those who could exert concrete agency in the form of resistance (e.g. counter-hegemonic movements) are instead on a powerless ground, awaiting a juncture of capitalist crisis when to finally subvert the pre-constituted order. Against this inactive scenario, this thesis aims at re-empowering agency with its political-economic resources. In this sense, agency should not represent a mere act of resistance which is temporarily left on stand-by until the next crisis of capitalism. It should be instead interpreted as the ability to relate to other agents and the surrounding reality; experiencing institutional and discursive structures; innovating such institutions and discourses in the attempt to leverage one's own strategies. This conceptualisation of agency accounts for circumstances which are specific – such as derivatives-based risk management in Italy or, more generally, the differential trajectories of financialisation – whilst at the same time capturing the exploitative and uneven character of capitalist relations.

In the next subsection, this work leaves the material and quantitative world of Régulation school, Post-Keynesian economics and Marxist political economy, to explore instead the discursive world of Foucauldian political economy. This approach does not identify structures prior to investigation, but explores instead how human agency reconstructs and interprets these structural constructions (Amoore et al., 2000, 62-63).

1.1.3 The everyday life of financialisation

Foucauldian-inspired political economists such as Marieke De Goede (2004, 2005) and Paul Langley (2009) redefine the study of finance from the vantage point of the collective production of discourses, identities and cultures.⁵⁴ This scholarship presents a fascinating enquiry into those cultural transformations which normalise finance as a technically rational and politically unchallenged domain. This subsection focuses first on De Goede's 'genealogy of finance' and successively on Langley's

⁵⁴These themes are central to a 'post-structuralist' understanding of the social reality. Post-structuralism denotes a heterogeneous corpus of research developed by French scholars such as Jacques Derrida, Michel Foucault, and Gilles Deleuze during the 1960s and 1970s. About post-structuralism and political economy, see De Goede (2006).

enquiry into the ‘everyday life’ of saving and borrowing.

Modern finance represents today a legitimate business activity that is supported by the technical achievements of financial economics. This status strikingly contrasts with the opinions that influential personalities as well as common citizens expressed in the mid-nineteenth century. At that time, stock markets were condemned as gambling arenas, repeatedly subjecting finance to heated political debates. How did this cultural transformation occur? How did finance become a legitimate business sector? De Goede (2005, ix-x, 1-8) aims at ‘disturbing’ the appearance of contemporary financial practices as a normalised and depoliticised dimension by reconstructing those historical struggles, debates, controversies, insecurities, and ambiguities that produced this status. In this regard, ‘genealogy’ is necessary to deconstruct the power of the financial discourse that is deemed to be ‘scientific’.⁵⁵

Genealogy is deployed as a method that accounts for the contingent and unstable emergence of a general discourse. In other words, whereas conventional history confers a sense of linear and inevitable unfolding of the events, genealogy reveals how the development of financial practices occurred in a non-linear manner, through historical insecurities that were written off to maintain a sense of depoliticised rationality in the events. On such intellectual grounds, De Goede proceeds in reading those moments when financial practices were most heavily subject to cultural struggles.⁵⁶ In so doing, she pays attention to those alternative arguments than were then marginalised once people began to ‘perform’ the dominant discourse.⁵⁷ Let us focus

⁵⁵This expression is based on Michel Foucault (1980, 84), whose ideas on genealogy constitute the core of De Goede’s analysis.

⁵⁶De Goede (2005) refers to the birth of public credit in seventeenth-century England; the conceptual separation between gambling and finance in the nineteenth century; the emergence and growth of financial statistics in the United States from the early twentieth-century onwards; the commodification of risk.

⁵⁷The notion of ‘performativity’ plays a central role in Foucauldian political economy. It implies that actors perform the dominant discourse through repetition and the permeation of their own identities (Butler, 1997). The concept is prone to an ambiguity between two similar interpretations (Brassett and Clarke, 2012, 4). In fact, whilst Foucauldians adopt the above-mentioned view on performativity, other scholars involved in social studies of finance deploy a narrower understanding of the notion (MacKenzie, 2006). By examining the micro foundations of markets, these scholars explore how economic models do not describe an external reality but perform the economy. In other words, models create the phenomena they describe (Callon, 1998; MacKenzie and Millo, 2003, 108). This narrower perspective on performativity traces back to John L. Austin (1962, 4-7) and his research on language philosophy. Austin described performativity as those ‘self-actualising’ statements that do not simply state facts, but enact what they name in the first place. For instance, the typical example of performativity is the priest who enacts the marriage by proclaiming ‘with this ring I thee wed’.

specifically on her study of the hedge fund LTCM and the contemporary dominant discourse: the commercialisation and regulation of global risk.⁵⁸

Established in 1993 by John Meriweather, former head of the Arbitrage group at Salomon Brothers, LTCM included in its board also Myron Scholes and Robert C. Merton, the two 1997 winners of the Sveriges Riksbank Prize in Economic Sciences in Memory of Alfred Nobel (see chapter two).⁵⁹ The hedge fund's business model represented the emblem of scientific finance, with both Scholes and Merton being at the forefront of the research on options pricing. Yet, in spite of its great use of sophisticated techniques and computers, LTCM started incurring losses in the early 1998, reaching \$500 million daily as a result of the Russian financial crisis in the August of the same year. The Federal Reserve System (FED), at that time chaired by Alan Greenspan, soon set up a recapitalisation of the hedge fund by pressuring its creditors to bail it out for the stability of global capital markets. Eventually, the managers were dismissed and LTCM shut down in 2000.

As a result of the fund's bail-out, a hearing opened in front of the US House of Representatives, where Members of Congress questioned the legitimacy of speculative profits, its unproductive character, and the unequal distribution of wealth at the basis of such activities. On the other side, Greenspan and William McDonough, then President of the New York Federal Reserve, justified the FED's intervention in the bail-out by blaming the extraordinary circumstances of global capital markets at the moment when LTCM started to incur its enormous losses. The two argued that, in any case, such rare disturbances should not be a reason for dismissing the achievements of the hedge fund in creating an efficient market. According to Greenspan (in De Goede 2005, 135):

[m]any of the things which [hedge funds] do in order to obtain profit are largely arbitrage type of activities which tend to refine the pricing system in the United States and elsewhere, and it is that really exceptionally and increasingly sophisticated pricing system which is one of the reasons why

⁵⁸Unless otherwise referenced, the following analysis is based on De Goede (2005, chapter 5).

⁵⁹Other partners were: David W. Mullins Jr. who was Vice chairman of the Federal Reserve (1991-1994); Eric Rosenfeld and William Krasker, two former professors at Harvard Business School who then joined the Arbitrage group at Salomon; Gregory Hawkins, Larry Hilibrand and Victor Haghani, who all came from the Arbitrage group at Salomon; Dick Leahy, an executive at Salomon; James McEntee, bond trader at Carroll McEntee & McGinley. For a history of LTCM, see Dunbar (2000) and Lowenstein (2002).

the use of capital in this country is so efficient. It is why productivity is the highest in the world, why our standards of living, without question, are the highest in the world.

The outcome of the hearings was the 2000 Hedge Fund Disclosure Act, which regulated hedge fund activities according to quarterly reporting requirements on their portfolios, leverage and risk evaluations. According to De Goede, this regulatory framework did not represent a ban on hedge funds, but rather a depoliticisation and normalisation of their operations. In other words, authorities created a legitimate discursive environment for hedge funds to operate. Regulatory efforts stabilised the cultural struggle by removing those critical elements concerning wealth distribution and productive benefits that some Members of Congress advanced during the hearings. Furthermore, the philosophy behind LTCM – the assumptions of financial trading as an efficient risk-management practice – still represents the major contemporary discourse that legitimises finance as a highly profitable business.

In sum, De Goede's genealogy disturbs the apparently depoliticised character of modern finance and its claims of scientific rigour. In order to 're-politicise' the practices of financialisation, it is necessary to reconstruct those cultural struggles that purified them throughout history. Resistance to the dominant discourse is to be encouraged in the present and emanated from multiple sources such as the Jubilee debt campaign, local currency schemes, political art, as well as alternative conceptions of financial security through a communitarian morality (De Goede, 2004, 2005, chapter 6).

Similarly to De Goede, Langley (2009, 1-5, 11-14, 20-40) explores the normalisation and depoliticisation of contemporary finance under the heading of shareholder democracy. For this reason, he focuses on saving and borrowing practices in the Anglo-American everyday life. Both dimensions are conceptualised as constituted by a myriad of interconnected networks that are disciplined by the power of seemingly scientific finance.⁶⁰ In these networks, individuals routinely perform neoliberal

⁶⁰Langley adopts the concept of 'network' in the sense given by actor-network theory. Scholars such as Michel Callon (1998) and Bruno Latour (2005) – two major exponents of actor-network theory – see networks as entities that are made of human participants and also technical devices. Networks give meaning to both human and non-human actions, reinforcing relatively stable behavioural patterns. These constructions change over time and extend across different spaces. By focusing on networks, Langley aims at decentralising global finance into separate but interlinked organisms.

self-discipline as a process of subjective identification that is nonetheless open to contradictions and dissent. The latter presents opportunities to repoliticise finance and dissolve the assumptions of scientific precision. Let us follow Langley's investigation into saving and borrowing routines.⁶¹

Langley argues that contemporary financial markets are not subject to mass irrationality as behavioural economics made us believe by presenting the notion of 'irrational exuberance' (Shiller, 2000).⁶² Today, stock-market bubbles – or the simple act of investing in financial securities – are instead possible precisely because they appear as a rational form of saving that partially displaced thrift institutions and insurance companies. Three intertwined aspects underpin the rationality of investing as a form of saving. First, everyday investment networks are extensive and increasingly interconnected with capital markets. They extend across different spaces, from daily life environments (household, workplace, high street) to the trading floors of Wall Street and the City. This allows people to trade stocks from their comfortable homes via for instance internet brokerage firms. Second, investment networks assume both direct and indirect ownership of many financial instruments. In this regard, a paradox exists: whilst the prevalence of investment as a form of saving incorporates growing strata of the population, the share of stock-market ownership by individuals has actually declined. This is because mutual funds and pension funds mediate the relationship between the investing public and the stock market. Third, new technologies associated with the calculation of risk are central to the consolidation of everyday investment as a legitimate form of saving. Too often, risk concerning future uncertainties is calculated by the investor as an opportunity to embrace. On the basis of a risk-reward trade off, risk entails benefits in terms of higher returns on investment. This conceptualisation of risk is radically different from thrift and insurance networks, whereby risk is a danger to be minimised and shared collectively.

For what concerns instead the high and unprecedented levels of everyday borrowing in Anglo-American societies, Langley argues that in order to understand this phenomenon it is necessary to address the qualitative transformations occurred in

⁶¹Unless otherwise referenced, the following review of Langley's analysis about saving practices is based on Langley (2009, chapter 2, 3, 4).

⁶²'Irrational exuberance' was an expression that Alan Greenspan coined in 1996 as a warning about assets being excessively overvalued during the dot-com bubble.

two principal market networks: consumer credit and mortgages. Let us see them in turn.⁶³

Credit cards represent the most emblematic form of consumer credit. These tools do not displace traditional networks of consumer credit such as loans and instalment plans, but they significantly expand people's purchasing power. Three calculative tools legitimised the use of credit card, namely: revolving credit; payment and authorisation systems; credit reporting and scoring. First, retailers or oil companies provided antecedents of modern credit cards since the early twentieth century. These cards were based on monthly instalment repayments. Universal third-party credit cards only emerged in the 1950s. For instance, cards like Diners Club and American Express were conceived as instruments to be used by travelling salesmen. In any case these were still settled on a monthly basis, and their circuits were very limited. It was only when Chase Manhattan and Bank of America introduced the innovation of 'revolving credit' to the credit card business in 1958 that an expanding network between credit card users, issuers and the financial markets emerged.⁶⁴ The use of revolving credit cards particularly consolidated during the 1980s, with their profitability being dependent on extending the period during which interest is charged. Hence, marketing campaigns and rewarding schemes aimed at pushing people to revolve on their credit, rather than paying off their account in full at the end of each month. Second, the business of revolving credit could not exist without the development of sophisticated payment and authorisation systems such as Visa and MasterCard. These technologies were both developed in the late 1960s, bringing together the buyer, the seller, their respective banks, and the card issuer in a calculative instance which lasts only those few seconds in which any transaction is executed in everyday buying and selling. Third, credit and reporting scoring provide card issuers with the necessary tools to evaluate credit worthiness and default risk. The specificities of credit evaluation transformed uncertainty into a calculable risk, making possible for revolving credit to become a mass phenomenon.

Besides credit cards, mortgages represent another fundamental ensemble of everyday borrowing networks. The latter are connected to capital markets and the

⁶³Unless otherwise referenced, the following review of Langley's study on borrowing practices is based on Langley (2009, chapter 6, 7, 8).

⁶⁴In the credit card business, revolving credit is an agreement by an issuer to give credit to a credit-card user (borrower) up to a maximum amount. For this privilege, the borrower is required to pay a commitment fee on the unused portion of credit and an interest on any loaned amount.

inflow of funds from export-led economies and oil-exporting countries. How do these linkages come about? Langley focuses the attention particularly on the off-balance-sheet management of borrowers' future repayments, since this practice radically transforms and extends everyday borrowing opportunities. For instance, during the post-war period banks managed the default risks of mortgages and other loans by matching the assets and liabilities of the balance sheet. Lenders would issue the mortgage and hold it in their assets, whilst collecting and monitoring the payments. On the contrary, contemporary securitisation techniques allow lenders to transfer these assets off the balance sheet. As a result, opportunities to provide more mortgages and other loans increase, whilst risk is supposedly diffused through efficient financial markets. In the last decade, an interesting linkage emerged between the world of high finance and everyday borrowing. In fact, foreign investors increasingly diversified their portfolios by including asset-backed securities instead of relying on the traditional market for Treasury bills. Thus, the inflow of funds from surplus economies contributes to the Anglo-American borrowing boom, connecting households to global capital flows via markets for securitised assets.

To sum up, Langley presents an insightful study about the everyday life of financialisation in Anglo-American societies, by focusing particularly on the myriad of saving and borrowing networks. He shows how these are linked to financial markets, creating a new form of financialised rationality that savers and borrowers routinely perform. The partial and contingent manner in which actors perform the financialisation of saving and borrowing opens up opportunities for dissent and repoliticisation of finance. Hence, in similar ways to De Goede, Langley pays attention to how subjective identities are constructed by performing the dominant discourse. In this regard, Foucauldian political economists acknowledge the agents behind financialisation. For this reason, they could give valuable tools to account for 'who', 'how' and 'why' adapt the practices of financialisation differentially across societies. However, in spite of these achievements, both the dimensions of performativity and disciplinary power prevent their approach from doing this. Why is this the case?

Both De Goede and Langley adopt the notion of disciplinary power as put forward by Michel Foucault.⁶⁵ Contrary to the case of Marxist political economy, power

⁶⁵Langley (2009, 33-35) attempts to move away from the notion of disciplinary power by emphasising the fact that individuals perform disciplinary power in a precarious manner. Therefore agents maintain considerable scope for political dissent. Yet, Langley does not place power at the

is no longer ideologically and materially wielded by particular class interests. It is instead grounded into an apparatus that disciplines society as a whole. Quoting Foucault (1977, 176) in one of his famous passages:

[power is] organized as a multiple, automatic and anonymous power; for although surveillance rests on individuals, its functioning is that of a network of relations from top to bottom, but also to a certain extent from bottom to top and laterally; this network ‘holds’ the whole together and traverses it in its entirety with effects of power that derive from one another: supervisors, perpetually supervised. The power in the hierarchized surveillance of the disciplines is not possessed as a thing, or transferred as a property; it functions like a piece of machinery. And, although it is true that its pyramidal organization gives it a ‘head’, it is the apparatus as a whole that produces ‘power’ and distributes individuals in this permanent and continuous field.

In this sense, the disciplinary power of financialisation rests on people performing the seemingly scientific character of modern finance and the culture of risk at a discursive level. This is a phenomenon which normalises and depoliticises finance deep inside the fabric of society.

At first glance, performativity and disciplinary power seem to provide a prolific conceptualisation of agency, one which opens up a terrain untouched by Régulation school, post-Keynesian economics and Marxist political economy: financialisation as the capillary permeation of people’s identities and libido. However, the two notions eventually produce an inactive view on agency. In fact, performativity confers excessive coherence to discourses that are experienced by people in a diversity of ways (Konings, 2009, 73-79). For instance, ordinary people may indeed have different concerns and strategic capabilities compared to, let us say, Henry Paulson or Richard Fuld.⁶⁶ Yet, performativity implies that all social agents are equal performers of financialisation, whether an individual is a US Secretary of the Treasury or a teacher in a countryside primary school. Differences amongst performing agents

level of agency, therefore missing the analytical tools to appreciate the differential trajectories of financialisation.

⁶⁶Two central figures of the 2007 subprime crisis, Paulson was US Secretary of the Treasury (as well as former chief executive officer of Goldman Sachs). Fuld was instead chief executive officer of Lehman Brothers.

are mostly irrelevant, since they altogether conform to the disciplinary power that normalises society as a whole. It is in this regard that Foucauldian political economy conceptualises agency in a static manner. Paradoxically, although the role of agency is acknowledged, it is nonetheless rendered inactive in its political-economic resources (Konings, 2009, 74). Power is beyond reach of single agents and it resides instead in the ethereal space of financialisation as a discursive regime.

As this thesis shows later, this inactive view on agency obscures two aspects that are crucial when exploring the differential trajectories of financialisation. First, some agents clearly put forward the discourses of financialisation to leverage their actions against other social forces. Second, and more importantly, agents do not merely perform the dominant discourse, but rather manipulate extant institutional and discursive structures in a *strategic* sense.⁶⁷ In so doing, they gain certain margins of control over the surrounding social reality they attempt to rationalise (Konings, 2009, 75). This aspect is important to the extent that it is only when agency is conceptualised in performative terms that financialisation appears as a homogeneous entity which manifests itself everywhere and in similar ways. Accordingly, institutional and discursive diversity is treated as a minor detail which is analytically insignificant. In other words, *if everybody perform the same dominant discourse everywhere and in the same manner, it is then difficult to appreciate how people experience financialisation with different objectives and perceptions, eventually producing distinct traits of financialised practices across societies*. In the end, De Goede and Langley emphasise the diffuse and performative character of disciplinary power to the detriment of asymmetrical relations amongst agents. Unfortunately, this move underplays the agential ability to experience discursive structures in a differential manner.

⁶⁷The term ‘strategic’ is based on Konings (2009, 75). This does not imply that people behave on the basis of cost-benefit considerations. This thesis adopts such term to show how human behaviours and emotions are open to infinite layers of historical complexity that the notion of performativity falls short of capturing. For a theory of social action which departs from the rational-actor model of mainstream economics, and adopts instead the insights of American pragmatism, see Beckert (2003) and Joas (1996).

1.2 A methodological turn in the financialisation debate: from structural to agential power

To recapitulate, the previous section has reviewed some amongst the main contributions to the financialisation debate: Régulation school together with post-Keynesian economics, Marxist political economy and, finally, Foucauldian political economy. These studies explore the crisis-ridden expansion of finance in modern capitalism, an aspect which challenges both the mainstream assumptions of capital market efficiency and the heterodox conceptualisation of global finance as a disembedding market force. However, whilst scholars are very attentive to the specificities of the Anglo-American case, they underplay the differential modalities through which other societies experience financialisation (Engelen, Konings and Fernandez, 2010, 57). In the end, the four reviewed approaches fall short of providing the suitable analytical environment to properly examine the specific developments of derivatives-based risk management in the Italian context.

As already mentioned in the introduction, scholars are currently mapping the impact of financialised phenomena across various countries and geographical areas in the attempt to remedy the lack of research on financialisation outside the US and the UK (Gabor, 2010; Kaltenbrunner, 2010; Marois, 2011; Paineira, 2010; Stockhammer, 2008; Orsi and Solari, 2010). In line with this trend, Engelen, Konings and Fernandez (2010) propose a preliminary cross-fertilisation between financialisation studies and the research programme on varieties of capitalism (Coates, 2002; Hall and Soskice, 2001; Streeck and Thelen, 2005). As they point out:

[...] the financialization literature is specific when it comes to the institutions underlying financialization processes in Anglo-American economies, but too generic when it comes to [...] financialization elsewhere. However, as the differential fallout from the credit crisis demonstrates, there are clear geographies to the trajectories of financialization that different political economies have undergone, suggesting that financialization studies need to be infused with a perspective that pays attention to the institutional specificities of different territories (Engelen, Konings and Fernandez, 2010, 57).

At first sight, this cross-fertilisation seems to represent a rigorous way to account

for the differential trajectories of financialisation. By contextualising the expansion of financialised practices within national models of capitalism, the analysis explains not only how they differ but also why they do so according to a variety of institutional configurations. Yet, this solution is not entirely satisfactory. Indeed, in the attempt to map different ideal-types of financialisation, Engelen, Konings and Fernandez overshadow the continuous process through which institutional and discursive structures are created and reinvented. To put it differently, a comparative study of financialisation across societies aims at photographing institutions in their structural condition, as fixed entities at a given point in time and space. But, this effort nonetheless underestimates the modalities through which (and the reasons why) these institutions are formed and constantly subject to strategic manipulation by agents. As a result, whilst the study certainly captures how and why ‘varieties of financialisation’ exist in their institutional steady state, it nonetheless falls short of explaining how and why these diverse models emerged in the first place and are open to continuous change.

To be exact, as this section shows later, Konings has advanced an insightful critique of the tendency to ontologise institutions in several other self-authored and co-authored works.⁶⁸ What is more, Engelen et al. (2011, 2012) have explored the role of political and financial elites in underpinning the institutional scenario which led to the 2007 financial crisis.⁶⁹ However, when proposing a cross-fertilisation between varieties of capitalism and financialisation studies, they do not clearly specify their argument compared to other works of their own. Hence, they tend to reveal the same problems of functionalism and inattention to history currently afflicting many comparative institutionalist studies. In fact, as Wolfgang Streeck (2010, 660-661) intelligibly explains, comparative institutionalism addressed a powerful critique to both modernisation theory and orthodox Marxism since the 1960s. Against the former, it emphasised the importance of politics as a source of diversity amongst different societies. In contrast to the latter, it highlighted the ability of institutions – most notably the state – to regulate and ‘suspend’ the self-defeating laws of capitalist

⁶⁸See for instance Konings (2006, 2008*c,b*, 2009, 2010*b*) and Panitch and Konings (2008).

⁶⁹Engelen has advanced this research on elites in collaboration with Ismail Ertürk, Julie Froud and Karel Williams, who are based at the Centre for Research on Socio-Cultural Change (CRESC), University of Manchester. These scholars avoid reifying capitalism and advance instead a ‘conceptually minimalist’ and ‘empirically resourceful’ approach which explores elites’ strategies, conjunctures and bricolage-like practices (Engelen et al., 2011, 14, 50-51).

motion. Yet, Streeck continues,

[...] what had begun as an investigation of the underlying social and economic forces driving the development of modern society turned into a ‘comparative statics’ of individual socio-economic institutions [...] More often than not, comparative institutionalism turned into pseudo-universalistic ‘variable sociology’: if you have centralized collective bargaining and an independent central bank, you can expect an inflation rate lower or higher than that of countries whose institutional *ameublement* is different [...] ‘Historical’ institutionalism meritoriously added policy legacies and institutional pasts to the set of variables that were routinely considered when trying to account for the structures and outcomes of political-economic institutions. Typically, however, it was not really history that was brought into play but – as in the study of ‘path-dependency’ – the costs of change as compared to its expected returns.⁷⁰

Taking into account the attempt of cross-fertilising the financialisation literature with varieties of capitalism, this thesis puts forward instead the necessity to reconsider the study of financialised phenomena in a methodological sense. As already pointed out, there is an important reason why financialisation studies are inattentive to the differential traits of financialised development across societies: they tend to conceptualise finance from the vantage point of structural power. Thus, any attempt to study financialisation and its adaptation outside the Anglo-American heartland should find a viable way out of this fundamental problem. Premised on this claim, the next subsections explain first in which sense the literature adheres to a structuralist view on power and why this prevents scholars from fully appreciating the distinct trajectories of financialisation. After this, the study puts forward the agency-centred approach. In this regard, the analysis brings power back at the level of agency in order to appreciate financialisation in its diverse proportions across space and time.

⁷⁰In the light of these considerations, Streeck (2010, 661-662) argues in favour of a ‘dynamic’ approach to comparative institutional analysis in order to make institutional change “no longer a special case but a universal condition of any social order.” Furthermore, Streeck emphasises the importance of developing an analytical context which is attentive to the complex interaction between specific institutional formations and more general capitalist dynamics.

1.2.1 Structural power and financialisation

Drawing from different disciplines and theoretical perspectives, scholars gathered around the debate on financialisation with a common purpose: questioning financial economics and its assumptions about finance being an efficient, innovative, beneficial dimension of modern capitalism. Against this view, financialisation studies aim at demonstrating that the power of finance is structurally entrenched in our social reality, producing dramatic inequalities and disarray. For this reason, the debate articulates financialisation and its multi-faceted phenomena through the lenses of structural power.

Régulationists and post-Keynesian economists interpret financialisation as the logical outcome of the Fordist capital-labour agreement in its unravelling. After the social tensions of the late 1960s and 1970s, the power of organised labour diminished to such an extent that the result was a dramatic increase in income inequality. This, in turn, asked for the expansion of the financial sector to support the aggregate demand by means of asset-price inflation, corporate growth based on mergers and acquisitions, wealth effect and credit consumption. In other words, the institutions of financialisation are seen as structures permeated by the influence of the *rentier* sector. The latter constrains the possibility to achieve a more sustainable form of capitalism by perpetuating income maldistribution, as well as distorting economic growth to the detriment of use-value production.

Marxist political economists go beyond the issue of income distribution and emphasise instead the labour-exploitative character of financialisation. This is the result of capitalism attempting to overcome its stagnating tendencies by not only expanding the circulative dimension, but also by opening up new sites for capital accumulation to take place. Instead of being limited to the traditional role of interest-rate earner, finance is now able to extract profit directly from labour by means of securitisation and derivatives. A growing industry of risk-management products lies behind these innovative financial instruments. Hence, according to Marxist studies, the power of finance capital is structurally entrenched in society, further expanding the frontiers of capitalism to the detriment of labour emancipation.

Foucauldian political economy takes us through a different route. Instead of articulating power as a force which causally constrains other economic sectors and classes, it adopts instead Foucault's more complex notion of disciplinary power.

In this regard, people perform the discipline of scientific finance at a discursive level, a phenomenon which depoliticises financial practices and the culture of risk behind a veil of technical professionalism. Although the role of agency is certainly acknowledged, it is nonetheless deactivated through the notion of performativity. Paradoxically, De Goede and Langley ultimately generalise the power of finance as a seemingly structural phenomenon.

In sum, scholars describe the structures of our social reality as penetrated by the power of the *rentier* sector, financial capital or the dominant discourse of scientific finance. In other words, power is entrenched and reproduced in social structures. Why is this problematic? To what extent does it prevent scholars from appreciating the differential traits of financialisation?

The concept of structural power has its origins in the work by Susan Strange (1988). It is the ability “to shape and determines the structures of the global political economy [e.g. security, production, finance, knowledge] within which other states, their political institutions, their economic enterprises and (not least) their scientists and other professional people have to operate” (Strange, 1988, 24-25). In so doing, Strange has stressed the fact that the interests and discourses of specific social groups are structurally entrenched in society, exerting power over other marginalised forces. Although not interacting directly with this study, the literature on financialisation conceptualises the power of finance in a similarly structural sense, articulating the relationship between structure and agency in the same inconsistent manner.

In fact, by demonstrating the finance-biased nature of our societies, financialisation scholars denounce a reality which should be radically transformed. To be sure, these are laudable reasons. However, when addressing finance from the vantage point of structural power, financialisation studies are subject to a fundamental contradiction, namely: if today’s reality is to be conceived as structures governed by powerful financial forces, how is it then possible to account for social transformation?⁷¹ At this point, the analysis resorts to the notion of agency as the ability to resist powerful structures and determine social change. In sum, the powerful institutions and discourses of financialisation are opposed to agency through a bi-directional causality. On the one hand, the structural power of finance establishes norms and rules that condition people and reproduce the status quo. On the other hand, agency

⁷¹This paradox and the following analysis concerning the opposition between structural power and agency are based on Knafo (2010, 497-499).

resists these structures and gives hope for social change at the right time and the right moment. Such causative dualism is very problematic, to the extent that it immobilises power within structures, whilst relegating agency to those rare moments of resistance against systemic forces. Power and agency are faced against each other as opposite poles. Power is omnipresent in the very structures of society, therefore it is accurately theorised in its general laws. Agency is merely understood as an act of resistance against structures. It is hardly examined, but simply acknowledged as a possibility and then left to a stand-by status.

This understanding of agency as opposed to structural power is the main reason why the debate on financialisation disregards how and why financialised practices differ throughout the globe. In this analytical scenario, there is no methodological space to articulate agency in active terms. Except for those moments of crisis, agents behave according to quasi-systemic dynamics and abandon their political-economic resources. In so doing, *the literature is unable to capture the agents who develop and constantly manipulate financialised institutions and discourses in a differential manner across societies; the reasons why they construct these institutional and discursive structures through power struggles and under historically distinct circumstances.* Without paying attention to active agency, financialisation ultimately appears as a homogeneous entity which replicates similar institutions and discourses everywhere. If diversity exists, it is nonetheless treated as a minor detail.

Hence, the dimension of agency needs to be opened up in order to explore how and why derivatives-based risk management emerged in Italy, as well as to which extent it reflects distinct spaces of financialisation. However, a crucial question comes up: how is it possible to account for active political-economic agency and historically specific events, whilst still emphasising the importance of structural constraints and asymmetrical power relations? The next section addresses this question by introducing the agency-centred approach.

1.2.2 Agential power and political-economic praxis

This thesis puts forward the idea that power should not be conceptualised as entrenched in the institutions and discourses of financialisation, reifying the latter as oppressive entities against powerless agents of resistance. *It is instead fundamental to place power at the level of agency, once institutional and discursive structures are*

*positioned in the context of a social relation amongst agents.*⁷² In this regard, Samuel Knafo (2010, 504, *my italic*) emphasises a simple, but often forgotten, aspect:

[...] what appears to be the product of structural constraints is always a product of agency when properly resituated within a social relation that takes into account the power of another actor exploiting these structural constraints. The agency/structure debate is thus ill defined because it examines the issue in terms of a dual relation between structure and agent, when in fact we are dealing with a social relation between agents which is only *mediated* by structures.

It is this ‘mediating’ character of financialised institutions and discourses that this thesis pays attention to. In fact, financial structures do not merely exert power over the manufacturing sector, labour, or society as a whole. They reflect instead the ability of some agents to shape in their favour the interaction with other actors through the mediation of institutional and discursive innovations. To put it differently, the relation between the structures of financialisation and the role of agency articulates in a ‘triadic’ manner (Konings, 2010*b*, 68). It does not entail an agent-structure dualism, but an *agent-agent* interaction that is mediated by complex institutional and discursive architectures. The subtle difference is that this triadic perspective on human interaction describes a scenario where agents do not face objectified power structures, but interact with other agents by continuously manipulating – or, more simply, relating to – institutions and discourses.

This triadic context brings profound implications for the way in which power is conceptualised. Indeed, power moves out of its structural constraints and becomes the agential ability to construct institutional and discursive architectures in order to gain leverage in a particular scenario. Power is interpreted at a pragmatic level where some agents are willing and intellectually able to experiment with existing institutions, to risk failure, to get lost in creative confusion and potentially advance innovative ideas that could become widely acknowledged institutions and discourses.⁷³ On the contrary, others abandon their search for empowering themselves,

⁷²It is important to note that the emphasis on agency does not entail an understanding of the latter as an independent and pre-existing entity. Unfortunately, an investigation about the social construction of agency lies beyond the scope of this thesis. For an entry point to this important theme, see Emirbayer and Mische (1998) and Konings (2010*b*).

⁷³This conceptualisation of power as praxis contains elements of bricolage (Engelen et al., 2010, 2011). It denotes the no-nonsense process of improvising with extant institutions and discourses.

switching off their creativity and accepting almost by default to experience the reality according to extant norms. In this sense, the new institutions and discourses leverage the power of those who advance them through experimenting and reforming, whilst at the same time gradually closing off opportunities for others. Still, far from becoming a structural reification of human reality, the newly created institutional and discursive environment reveals opportunities for manipulation through contested political-economic praxis.

In fact, what is important to appreciate in this triadic context is that it presents a paradox which becomes prolific for empowering purposes. When agents create new institutions and discourses, these do not simply constrain other agents, but also *enable* them to experience imperatives in potentially infinite ways – often innovatively modifying them.⁷⁴ In other words, referring to a problem which spurred the emergence and contradictions of linguistic structuralism, grammar contains a set of rules which create imperatives and constraints. But, considering how neologisms are constantly introduced in dictionaries, it is clear that linguistic rules are nonetheless subject to numerous transformations. In this regard, what is today considered an error might not be considered as such in the future (Knafo, 2010, 503).

As Konings (2010*b*, 65-72) explains, American pragmatist philosophers such as William James, John Dewey and George Herbert Mead appreciated these enabling characteristics of institutional structures and how the latter potentially empower the creativity of human beings.⁷⁵ Pragmatists approached modernity at the turn of the twentieth century as an opportunity for new forms of institutional interactions to emerge. To put it simply, the development of capitalist relations were not seen as an increasingly objectified reality, but as a multiplication of possibilities for human association. To be sure, whilst emphasising the enriching side of modernity, pragmatists underestimated the power and inequalities which reigned in that period. However, their focus on the enabling qualities of institutions presents insights that are crucial for capturing the contested nature of human reality. It sheds light on how agents produce power by building institutional and discursive structures that leverage their actions vis-à-vis other actors in specific historical contexts. Yet, the

⁷⁴With regard to the enabling qualities of institutions, there are certain similarities between the agency-centred approach and structuration theory as developed by Anthony Giddens (1984).

⁷⁵About the philosophy of pragmatism in the United States, see Livingston (1997) and Joas (1993).

newly established institutions and discourses do not just restrict other agents' behaviours, but also allow them to make sense of those structural imperatives in their own words. In so doing, other actors manipulate extant structures by means of their own agential power.

1.2.3 Applying the agency-centred approach to the case of derivatives in Italy

What does the agency-centred approach imply for our analysis concerning the distinct traits of derivatives in Italy? The dynamics of agential interaction, power struggle, mediating and enabling institutions shift the focus away from the analytical opposition between structural power and agency. As shown above, the latter ultimately portrays financialisation as a quasi-objectified and homogeneous entity oppressing the agents of resistance who are left at the margins. Against this, the agency-centred approach positions power at the level of agency, therefore giving actors the resources necessary to create and renegotiate institutional and discursive structures on the terrain of political-economic praxis. In this historically sensitive scenario, financialisation – far from being a reified system – finally appears as a continuously *differentiated* ensemble of institutional and discursive architectures in the making. These institutions and discourses reflect the agential power of certain social forces who advance them to make sense of the surrounding reality and to leverage their own position vis-à-vis other forces. In spite of facing an asymmetry in power relations, other actors are nonetheless capable to experience these institutions and discourses in their own strategic terms.

Derivatives in Italy are the perfect example to illustrate such distinct dynamics of continuous institutional and discursive building. As chapter three and four show, technocrats and centre-left politicians adopted derivatives as essential to their strategies. It all began when technocrats at the Bank of Italy and the Ministry of Treasury imported the institutions and discourses of derivatives-based risk management in the early 1990s. They did so as part and parcel of their attempt to renovate the available technology for the management of public debt in order to contain its dramatic expansion. At various stages, the central objective of stabilising public finance was accompanied by other neoliberal-inspired ideas such as the privatisation of the state-owned sector and, later in the decade, the shareholder-oriented trans-

formation of the corporate governance regime. These strategies directly challenged those conservative forces whose reproduction depended on high levels of public expenditure, the enlargement of the state-owned apparatus and the concentration of corporate ownership in the hands of few oligarchs.

Over the course of the 1990s, it became clear to technocrats and centre-left politicians that their project of modernisation – that is, rendering Italy a normal country – was highly intertwined with the participation in the process of European integration. Europe became fundamental to impose an external constraint on the ability by domestic conservative forces to exploit their traditional mechanisms of political-economic reproduction (Dyson and Featherstone, 1996). In this scenario, several technocratic governments and the centre-left coalition – which got to power in 1996 – undertook Herculean efforts to renew the domestic institutional and discursive environment, primarily by slashing government expenditure, taming labour relations, privatising the system of public enterprise and modernising the financial system (Sbragia, 2001; McCann, 2000; Deeg, 2005*b*). All these reforms were undertaken in the name of Europe, a mantra which served very well the purpose of attracting the consensus of pro-European elites and the public at large (Quaglia, 2011).

Derivatives had a crucial role in these strategies. To begin with, technocrats exploited the intricacies of OTC derivatives markets in order to drive interest-rate convergence between the Italian and German bonds (Dunbar, 2000, 149-162). However, this was not enough to join EMU in 1999. Despite the drastic austerity measures, authorities forecast a level of budget deficit which fell short of 3 per cent for the year 1997. It is at this point that the practices of derivatives-based risk management assumed their most strategic essence. Whilst implementing further austerity cuts, the Treasury entered into a rather peculiar currency swap. In brief, this operation allowed Italy to receive from its counterpart a large amount of money to be counted as a reduction in the interest expenditure for the years 1997 and 1998. Only later, the Treasury had to disburse a greater amount of money to its counterpart at the expiration of the swap in the late 1998 (Piga, 2001, 122-129).

It is not entirely clear how much this swap artificially affected the budget deficit reduction in 1997. Yet, the story shows what is most significant for the purposes of this thesis: it is only when the dimension of agency is properly explored that the idea

of financialisation as a quasi-homogeneous entity dissolves into a constellation of distinct and unintended dynamics. In fact, although the institutions and discourses of derivatives-based risk management cast a seemingly universal character across the world – in the end, the mechanics of a currency swap are by and large the same everywhere – Italian actors adopted them for their own specific tactics, therefore generating differential traits. Furthermore, constructing the market-oriented institutions and discourses did not lead to an objectified reality. On the contrary, whilst technocrats and centre-left politicians aimed at eradicating conservative interests, other actors such as the Agnelli family and municipalities adopted the very same derivatives techniques to oppose neoliberal reformist ambitions.

1.3 Conclusions

This chapter has reviewed the merits of financialisation studies in critically investigating the expansion of financial markets, instruments, actors and motives in modern capitalism (Epstein, 2005, 3). Yet, whilst the literature is particularly attentive to the case of Anglo-American societies, it underplays the differential trajectories of financialisation across the world. This problem prevents financialisation studies from fully capturing the distinct features of derivatives-based risk management in Italy.

The chapter has argued that scholars are inattentive to financialisation and its globally differential diffusion as a result of their view on finance from the perspective of structural power. The power of finance is entrenched and objectified in the structures of society, creating an analytical context where it is difficult to articulate the agents who adapt the institutions and discourses of financialisation in a differential manner. Without an enquiry into the dimension of agency, financialisation is then reduced to a phenomenon which manifests itself homogeneously.

Against this structuralist view on financialisation, the chapter has introduced the agency-centred approach in order to position power at the level of agency. Agential power accounts for a social reality where actors are not passive bystanders against the structural power of finance. On the contrary, they interact with other agents through the mediation of continuously renegotiated institutional and discursive structures. In this context, power is not objectified in social structures, but generated by agents when developing strategies to modify extant institutions and discourses as a lever-

age to their actions (Knafo, 2010; Konings, 2010*b*). This agency-centred approach provides the historically sensitive context where to appreciate how and why different spaces of financialisation exist.

The next three chapters explore the dynamics of agential interaction, power struggle, institutional and discursive mediation creating the distinct traits of derivatives in Italy. Chapter two detours the analysis around the Italian context and it examines the origins and evolution of this powerful innovation in the United States. Due to the crucial role played by US capitalism in the development of derivatives, it is necessary to focus first on the specificities of the American case and to postpone the analysis concerning Italy to chapter three and four.

Chapter 2

Derivatives-based risk management in the United States

This chapter begins our enquiry into the world of derivatives. It examines these instruments as essential constituents of American financial power in the contemporary global order. The central claim is that societies used derivatives-like contracts long before the consolidation of commodity futures in the United States during the late-nineteenth century. However, it is only at this point in history that derivatives were gradually embedded in an institutional and discursive environment attuned to market speculation as a mechanism of risk management. In so doing, derivatives became the vehicles through which the risk of commodity price volatility was isolated, quantified and managed via speculative trading. In a word, derivatives-based risk management came into shape as a powerful innovation of modern times.

In the early 1970s, under circumstances in which the influence of American finance became pressing, the practices of derivatives-based risk management – which in many respects were stagnating in the realm of commodity exchanges – were adapted to financial markets and the risk that asset volatility entails. From this moment onwards, following the expansion of American financial actors at home and abroad, derivatives markets and instruments grew as a phenomenon of global proportions. Their risk-management qualities enticed the minds of financial practitioners and pro-market reformists across different societies. Derivatives were projected as a ‘mantra of precision’ (Wigan, 2009, 160), the techniques of which transcended the immediate realm of securities markets to approach instead the risks experienced by

society at large (Bryan and Rafferty, 2011).

Financialisation studies underestimate the historical origins of derivatives-based risk management. Régulationists, post-Keynesians and, to some extent, Marxists disregard the phenomenon in question. De Goede (2005, chapter 3) provides instead a fascinating investigation about the discursive scenario in the United States during the late-nineteenth century. She shows that speculation was normalised as a scientific mechanism of risk management, providing legitimacy to stock and commodity exchanges which up until then were considered as gambling arenas. However, De Goede's analysis falls short of capturing the power struggle upholding the institutional and discursive construction about 'scientific speculation'. In other words, although the creation of this discourse was extremely important, it was nonetheless advanced strategically by specific agents on the ground. It did not reflect the disciplinary power that permeated society as a whole, but the agential power of certain social forces (representatives of commodity exchanges, traders, agricultural entrepreneurs, etc.) over others (populist movement, farmers, workers, etc.). What is more, once consolidated, these institutions and discourses were subject to continuous manipulation as part and parcel of agential strategies.

The chapter is outlined in three main sections. The first section traces the origins of derivatives-based risk management back to the creation of futures markets in the United States during the second half of the nineteenth century. It shows how futures trading rethought speculation as crucial to manage the risks inherent to business activities. The section explains that the gradual institutionalisation of futures was neither a matter of economic efficiency, nor did it occur with the consensus of the vast majority. The process of institutional construction – when agents advance new institutions and discourses – articulated instead during the Gilded Age, at a time when the debate about futures approached broader social, political, economic and cultural complexities. In those years, advocates of futures markets faced a fierce opposition by the growing populist movement, which considered futures trading as the worst facet of agricultural commercialisation. Futures brought new competitive imperatives that favoured large entrepreneurs to the detriment of self-subsistent farming (Levy, 2006). Out of this intense battle, the populist platform was eventually diluted into the making of the American dream during the Progressive Era, with its pro-consumerist reforms which ameliorated, rather than questioned, corporate

industrialisation (McCormick, 1986, 269). The debacle of populism opened the space necessary for the advocates of futures trading to enact their ideas about speculation as a valid practice of business-risk management. Thus, after legal and regulatory efforts, futures thrived as an integral dimension of modern America.

The second section moves the analysis to the 1960s and early 1970s, at a time when commodity futures were regulated by the New Deal reforms. It is in this period that derivatives – as thus far known on commodity exchanges – began to intersect the vicissitudes of American finance and its expansionary configuration at home and abroad. Once transferred from commodities exchanges to the dynamic world of financial markets, derivatives were rethought as instruments of risk management for financial investors. Two specific social forces successfully lobbied to emancipate derivatives from their commodity basis – a process which faced instinctive hostility by the American establishment. First, top managements of both the CBOT and the Chicago Mercantile Exchange (CME or, more colloquially, the Merc) searched for profitable opportunities and decided to apply their expertise on financial assets, respectively stock options and currency futures (MacKenzie, 2006, 147-150). Second, the academic discipline of financial economics considerably helped commodity exchange officials. From their prestigious ivory towers, academics isolated risk and price volatility as fundamental categories of the investment science (Wigan, 2009, 160-163). In so doing, they legitimised in theoretical terms the importance of stock options and currency futures as instruments through which investors manage their risk exposures to financial-asset volatility. The linkage between derivatives and finance occurred at a time when the Nixon administration was increasingly conducive to the interests of financial actors. In fact, after the collapse of the Bretton Woods monetary system in August 1971, policy-makers gradually realised that American finance constituted the main driver of US global power (Gowan, 1999).

The final section concludes by looking at the expansion of financial derivatives over the course of the 1970s and 1980s. It does so by exploring these instruments as fundamental elements of American financial power in its conflictual construction. During the 1970s, derivatives trading on financial assets grew considerably and became an essential activity for banks and institutional investors. However, in many respects, this growth was hindered by regulatory uncertainties as well as an economic scenario in which inflationary pressures were accompanied by recession, capital out-

flows and a declining value of the dollar (Panitch and Gindin, 2008, 30). In 1979, the monetarist turn of the Federal Reserve ended the class-based contradictions which had afflicted the US economy for a decade. In so doing, the domestic institutional environment was finally ready to fully benefit from American finance and its expansionary features (Konings, 2008*c*, 53-55). It is at this point that American financial power consolidated in its global reach. Accordingly, the 1981 Shad-Johnson Accord adjusted – at least temporarily – the respective regulatory competencies of the Securities Exchange Commission (SEC) and the CFTC concerning derivatives. This allowed derivatives markets to grow in size and rate of innovation, as demonstrated by the cases of index derivatives and two over-the-counter instruments: swaps and asset-backed securities. Several studies confirmed the significance of derivatives in the management of banking risks and in improving the liquidity of the market for US Treasury securities (Markham, 2002*c*, 90). This view on derivatives was hardly affected by the 1987 stock market crash. On the contrary, this and other critical events encouraged instead the US government to push for a market-oriented regulatory infrastructure upholding the growth of financial innovation (Rude, 2008). As other countries differentially adjusted to the dynamics of American financial power, the institutions and discourses of derivatives-based risk management diffused outside the US boundaries.

2.1 The origins of derivatives-based risk management

Antecedents of modern forwards, futures and options existed for a long time before the emergence of American commodity markets. Edward J. Swan (1999) shows that contracts for the future delivery of grain products were already negotiable and regulated in the Babylonian temples around the 1750 BC at the time of Hammurabi. These forwards-like instruments related primarily to the delivery of agricultural products and commodities. It was like that for a large part of human history until the emergence of chartered companies in the seventeenth century encouraged the use of contracts for future delivery also on company shares. This activity developed in Amsterdam during the period of the Dutch Republic (1581-1795) and was successively exported to London (Gelderblom and Jonker, 2005). In fact, traders gathering

in the coffee houses around the Royal Exchange used contracts for future delivery on both commodities and shares (Braudel, 1983, 106-110). Here, during the South Sea bubble of 1720, options-like contracts on the South Sea shares were also given for free to influential personalities (MacKay, 1841). Furthermore, these practices were subject to heated debates and regulatory experiments such as the Sir John Barnard's Act in 1733 and the Gaming Act in 1845 (Swan, 1999, 184-190, 211-213).

Yet, in spite of such significant developments, these antecedents of modern derivatives never circumvented one important limit: the final delivery of the underlying commodity. This happened only with the creation of futures markets in the United States. To be sure, Antwerp merchants used contracts known as *contrats de gageures et d'assurances de changes* already during the sixteenth century. These contracts allowed two parties to settle profits and losses according to movements in the price of the underlying asset without any ownership transfer of the underlying itself (Swan, 1999, 144). However, their use was not institutionalised and subject to regulation as it occurred in the United States. Speculative trading on US futures markets was embedded in an institutional and discursive environment which recast speculation as a valid mechanism of business-risk management.

This section explores the social agents, their relations of power, as well as the mediating institutions and discourses through which they interacted, eventually leading to the legitimisation of futures trading and speculation. It begins by introducing the creation of futures markets – particularly the CBOT – and the challenges of populist politics during the Gilded Age. Then, it looks at the legal battles between the CBOT and bucket shops in the early years of the Progressive Era. These events were crucial to the full acquittal of futures trading. Finally, it concludes by reviewing the Federal regulatory frameworks implemented during the latest phase of the Progressive Era and the New Deal reforms.

2.1.1 Futures markets and populist politics in the Gilded Age

Commodity and agricultural trade was very disorganised in the American colonies. In 1770, the New York Chamber of Commerce was the first organisation which aimed at encouraging trade and settling commercial disputes. Successively, Boards of Trade were established in Baltimore and Philadelphia, respectively in 1821 and

1834. It was along this trend of growing commercialisation that local businessmen in Chicago felt the necessity of establishing a Board of Trade. After a series of meetings, the Chicago Board of Trade was founded in April 1848. During the first decade, the growing trade of grain was organised through to-arrives. Buyers and middlemen entered into these forwards-like contracts before delivery. Then, the grain was stored in the elevators until it was distributed according to the terms of the contract (Stone, 1911; Markham, 2002*a*, 266-268).

In 1858, this relatively simple business began to change into a modern futures markets when the CBOT established a department for the inspection and classification of grain (Merrill, 1911, 59). One year after, the Illinois legislature granted a corporate charter to the Board, giving the organisation self-regulatory authority over its members and the process of grain classification (Cftc, 2011). The standardisation of grain created the technical basis over which to-arrive contracts were transformed into widely transferable futures. In brief, futures were flexible enough to be traded on the market. In 1865, CBOT created three important elements of an organised exchange. First, it built octagonal concave areas known as *pits*, where traders exchanged the contracts by communicating through an open-outcry system. Second, a system of margins requirements was established. Finally, contracts began to be cleared and settled through specific rules (CME, 2011). These three innovations consolidated the early technology of futures trading.

As soon as the CBOT established a futures exchange, a fundamental aspect came into light: futures contracts allowed traders to circumvent the necessity to deliver the underlying commodity. In fact, the specifics of futures trading were such that contracts could be closed out before expiration and settled through cash differences. Here, profits or losses were adjusted according to price movements of the underlying commodity without any ownership transfer of the commodity itself. As a result, CBOT attracted traders who were hardly interested in the actual delivery of the underlying commodity, but rather speculated on its price volatility. Traders in Chicago soon came to be known for their ruthless techniques and violent folklore (Geisst, 2002, 9).

At this point, a powerful rationale emerged in futures markets, one based on an ambiguous relationship between hedging and speculation. In the case of forwards-like contracts, speculation remained inherently limited by the fact that the physical

commodity must be eventually delivered. A radically different phenomenon occurred instead in the case of futures trading. Here, traders took long positions when they anticipated an increase in the price of an underlying commodity. Vice versa, they took short positions if they anticipated a decline in its price. Due to the process of daily cash settlements and the possibility of closing out contracts, traders hardly ever exercised futures contracts at expiration. In this regard, futures markets were the most striking example of speculation. American futures exchanges made even those participants with hedging necessities – such as the grain dealer Andrew J. Sawyer (see technical excursus and figure 2.1) – act also in a speculative guise (Levy, 2006).

The Chicago Board of Trade was the first organisation to introduce these speculative techniques which other exchanges then emulated. In fact, commodity markets proliferated across the country and gradually began to trade futures. However, this expansion soon met obstacles. As the United States proceeded along the path of agricultural commercialisation, the practices in use on futures markets were subject to intense controversy. Whilst strongly contested in an anti-capitalist guise by anarchists (Avrich, 1984), commodity exchanges were particularly discredited by farmers who in those years were building a political identity by joining en masse the nascent populist movement. Farmers exalted the virtue of productive labour, certainly not the profits accrued through speculation. As a result of such an intense agrarian sentiment, futures trading suffered enormous political, legal and cultural challenges well beyond the levels endured by stock markets (Geisst, 2002, 4). Why did futures markets represent a thorn in the side of the populist movement?

After the Civil War (1861-1865), farmers contested the industrialisation of the American society and the commercialisation of their way of life (Mayhew, 1972). At a fast pace, from the Northeast regions to Western and, in some respect, Southern territories, the Jeffersonian myth of the independent yeoman was becoming entrenched into market dynamics as borrower, producer, seller and consumer.⁷⁶ To be precise, farmers did not reject commodification tout court, but the emergence of new competitive imperatives the complexity of which they hardly controlled. They rather aimed at playing an active part in the opportunities of modern life (Postel, 2007), but these opportunities were not given to them in those decades.

Futures trading was one of the most controversial aspect behind the market-led

⁷⁶On Thomas Jefferson and democracy, see Hardt (2007).

transformation of the American countryside. Farmers were very concerned with the disruption caused by traders speculating on fictitious produce (Emery, 1896; Lloyd, 1883; Stevens, 1887). Futures drastically dispossessed farmers from any control over the determination of crop prices. To all, the situation appeared as paradoxical. Whilst farmers were heavily affected by declining produce prices, speculators simply entered into short positions to profit from such a fall in price. Adding insult to injury, these perverse instruments were turning into profitable vehicles of market power for capitalist-minded agricultural proprietors. In fact, whilst small farmers failed to access the complex world of futures, the new agricultural entrepreneurs were instead well informed about how to enter into futures positions to hedge their business. At a time when the former were gradually squeezed out of the market, the latter were growing to dominant positions (Levy, 2006). It was under these circumstances that futures trading visibly clashed with the populist programme of cooperative democracy such as the sub-treasury land and loan system. The latter implied the socialisation of agricultural risk through government-owned warehouses and certificates to pay the farmers for their produce (Goodwyn, 1976, 90-93).⁷⁷

The influence of the populist platform was so strong that growing pressures for Federal regulation soon came to be felt. For instance, Democratic Congressman William Hatch launched an attack on futures trading by introducing the Hatch bill in 1892. The initiative was designed to restrict speculation by heavily taxing short selling. Unfortunately, the proposal was eventually abandoned (Parker, 1911, 141-142).

Four years after the Hatch bill debacle, populists – which in the meantime had consolidated their political platform in the newly established People’s Party (1891) – suffered a disastrous defeat in the presidential elections of 1896, when they supported the Democratic candidate William Jennings Bryan (Postel, 2007, 269). The victory of the Republican William McKinley inflicted a decisive blow to populist politics. The event inaugurated the so-called ‘system of 1896’, a long period of Republican hegemony which aligned political elites to those corporate magnates who were transforming the American political-economic landscape (Konings, 2006, 102).

⁷⁷The sub-treasury land and loan system was put forward by the populist leader Charles Mancune in 1889. According to Mancune, the Federal government would have issued legal tender notes – known as greenbacks by the name of their ink – to provide credit for farmers. Furthermore, government-owned warehouses (or sub-treasuries) would have used Federal sub-treasury certificates to pay the farmers for their produce. See Goodwyn (1976).

As the fortunes of the populist movement faded away, commodity markets were already on their way to become organisations of civic pride and capitalist ethos.

Yet, despite the decline of the populist movement, political and legal pressures to ban or restrict futures trading were far from over (Cowing, 1957). As the hearings during the Hatch bill showed, a fundamental issue separated advocates of futures markets from the legitimacy of their business: the fictitious nature of futures trading. Representatives of futures markets argued that futures were an important activity which, like insurances, concretely helped the American economy manage its business risks. To be sure, speculation thrived on organised exchanges. But, the latter performed a very important function. By entering into long or short positions on the basis of their probability calculations, speculators were risk-management professionals who provided market liquidity for hedgers. However, against this argument, a legal conundrum still persisted: how was it possible to differentiate futures trading and speculation from gambling? In fact, as long as futures hardly involved the final delivery of the underlying asset, it was impossible to discern speculation as a supposedly legitimate business practice (Levy, 2006).

It happened that in those years the Chicago Board of Trade was involved in a legal battle against pseudo-brokerage houses known as bucket shops. These circumstances eventually marked the complete acquittal of speculation on futures markets and the practices of derivatives-based risk management. Let us focus on these events. Successively, the analysis concludes with a review of the Federal regulatory frameworks which the authorities implemented during the Progressive Era and the New Deal.

2.1.2 Adjusting society to the probable

Bucket shops were a peculiar phenomenon which proliferated in those decades. In spite of their similarities with brokerage firms, these shops were betting parlours where customers traded with proprietors and calculated profits or losses on the basis of changing prices (Fabian, 1999). Bucket shops were connected to the network of stock tickers that, from commodity exchanges and stock markets, spread through all brokerage houses (Preda, 2009). But, their transactions had no real effect on stock and commodity prices. In this sense, the quotations generated by traders reached the shops in a unidirectional manner (Hochfelder, 2006, 344). In a climate where

legendary traders piled up their fortunes, bucket shops gave average Americans the impression that, for a few cents, they too could become rich (Geisst, 2002, 3).

During the congressional hearings for the above-mentioned Hatch bill, representatives of commodity exchanges and traders had clearly differentiated their speculative activities from the accusations of gambling on the basis of a specific legal formula: *contemplation of delivery*. According to this definition, the contract had to state the physical delivery. However, as long as one party ‘contemplated’ delivery in her mind, then the contract could also be closed out before expiration. Whilst organised exchanges adhered to this legal practice, bucket shops failed to do so because they did not involve the final delivery of the underlying asset at all. This legal artifice was soon adopted across the country with courthouses carefully examining the mindset of traders (Levy, 2006, 318-321, 327). However, public opinion hardly made a distinction between bucket shops and organised exchanges. The formula of contemplating delivery was deceptive ‘legalese’ hiding a reality in which, just like bucket shops, exchanges made no delivery either. This popular perception was fully embraced by bucket shops owners who argued that organised markets were simply large shops establishing monopoly power (Cowing, 1957, 407).

In this scenario, advocates of futures markets began to realise that the battle for the legitimacy of futures trading necessarily involved a strategy of differentiation from gambling and bucket shops. The case of the CBOT is emblematic and deserves to be examined. Already during the 1880s, the Chicago Board of Trade claimed property right over price quotations. It prohibited their dissemination in the attempt to remove the basic information over which bucket shops were betting. But, in 1889, the Illinois Supreme Court ruled against CBOT’s claims of ownership rights whilst bucket shops kept proliferating. Hence, by the early 1890s, representatives of the CBOT shifted their attention towards internal reforms in order to demonstrate the professional integrity of futures trading on organised exchanges vis-à-vis bucket shops. CBOT improved contract rules and prohibited members from dealing with bucket shops (Lurie, 1972, 233). In so doing, CBOT officials were slowly constructing the institutional and discursive basis to isolate ‘scientific’ speculation from mere gambling. In the mindset of futures trading advocates, the exchange pits provided real value. Even the most speculative actions nonetheless generated an efficient and liquid market. Bucket shop transactions were instead fraudulent, and their owners

represented “economic parasites who fed off exchanges’ quotations and drained their customers’ pocketbooks” (Hochfelder, 2006, 350).

In 1900, rumours circulated that the CBOT and Western Union Telegraph Company were reasserting control over price quotations. This news was enough for Christie-Street Commission Company – a large bucket shop based in Kansas City – to file a lawsuit. It was the beginning of a conflict which protracted from 1900 until 1905 and was in large part transferred to the Federal courts. This legal battle brought unexpected outcomes which legitimised futures markets and their professionalism as fundamental to the nation. The litigation included forty-six cases and extended across eleven states and fifteen cities (Lurie, 1979, 75-104, 138-198). During this time, after a defeat in the Illinois courts in 1901, Christie changed its name into Christie Grain & Stock Company. Two moments came to be central in this battle. In 1903, the Circuit Court of St. Louis stated that:

[...] the Chicago Board of Trade [...] members [...] engage in making and carrying through deals in grains and provisions, in which it is not intended to make a future delivery of the article dealt in, but which are to be settled by payment of money only according to the fluctuations of the market and which are in all essentials gambling transactions. (Ferris, 1988, 126)

This declaration represented a significant victory for the bucket shop. For the Chicago Board of Trade instead, it was clear that after all the efforts to build up business integrity, one major problem still remained: most part of the transactions on the exchange merely contemplated physical delivery, but were in reality set off through differences. In fact, Christie centred its legal strategy on emphasising the fictitious nature of trading on the pits. By arguing on this point, the bucket shop hoped that courts would condone both the shops and the exchanges, rather than banning futures trading.

However, in 1905 the case reached the US Supreme Court where the historical decision was finally delivered by Justice Oliver Wendell Holmes, Jr. in the following words:

[...] in a modern market, contracts are not confined to sales for immediate delivery. [...] *Speculation of this kind by competent men is the self-adjustment of society to the probable.* Its value is well known as a means

of avoiding or mitigating catastrophes, equalizing prices, and providing for periods of want. [...] This court has upheld sales of stock for future delivery and the substitution of parties, provided for by the rules of the Chicago stock exchange. (USSupremeCourt, 1905, 247, *my italic*)

In sum, futures contracts were deemed to be important commercial instruments, even though the physical delivery of the commodity was not involved. CBOT and other organised exchanges were a source of national prosperity due to their careful analyses computed by professionals who ‘adjust’ society to the probable. Contrary to what occurred in bucket shops, exchange activities were based on calculated knowledge and not on fortuitous wagering. For this reason, exchanges maintained their property right over prices. These were considered a trade secret and bucket shops were effectively excluded from accessing such information. The decision taken by the Supreme Court dealt a decisive blow to the business of bucket shops which gradually disappeared (Fabian, 1999).

C. C. Christie, the owner of Christie Grain & Stock Company, commented with remarkable words on the decision taken by the US Supreme Court: “I know now that this band of hypocrites are busy adjusting society to the probable” (in Levy 2006, 331). In all his bitterness, Christie was not entirely wrong. In fact, if the events are clearly examined, an important question emerges: could not bucket shops adjust society to the probable as well? In this regard, Jonathan I. Levy (2006, 327-328, 335) advances the hypothesis that bucket shops worked just as well as organised exchanges to smaller customers betting for hedging purposes. This interpretation introduces important elements concerning the competitive dynamics between formal exchanges and bucket shops. According to Levy, hidden behind assumptions about the professionalism of exchange traders, the decision announced by Justice Holmes was a truly political one. Bucket shops were as good as organised markets in contemplating delivery. However, exchanges had something more than bucket shops: these organisations – with their expensive memberships and margin requirements – were instrumental to large handlers like Andrew J. Sawyer (see technical excursus and figure 2.1) in creating their market power in the age of corporate America.

The next and final subsection focuses on the regulation of futures markets during the Progressive Era and the New Deal. Over the course of these three decades, power relations were such that the validity of futures markets was hardly questioned.

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Figure 2.1: Advertisement for Andrew J. Sawyer, a grain producer and distributor, 1891.

Sawyer was an active participant in commodity futures markets. Reprinted from 1891 *Grain Dealers and Shippers Gazetteer*. Source: <http://www.memoriallibrary.com/Trans/RRGaz/ADS/sawyer> [accessed on December 30, 2012].

Authorities aimed instead at regulating speculative excesses within the boundaries of hedging necessities.

2.1.3 The Federal regulation of commodity futures: from the Progressive era to the New Deal reforms

Justice Holmes provided legal legitimacy to futures-based risk management, but the decision hardly stopped farmers malcontent. Yet, the unfolding of the Progressive Era was such that the claims of the agrarian population were slowly diluted into consumerist aspirations (Calder, 1999; Konings, 2006, 103-105). This attitude well reflected the spirit of the times, when reformists intervened “not to dismantle modern industry and commerce but rather to improve and ameliorate the conditions of industrial life” (McCormick, 1986, 269). In this regard, they revealed a genuine outrage against the corruption and collusion of corporate power – in particular, the J. P. Morgan-centred trust. But, the purpose of their critique was to assist corporate capitalism rather than questioning its true foundations.

Futures trading experienced a similar stance. Hardly contested in their actual existence, markets faced instead regulation on two fronts. First, at the level of self-regulation, exchanges constantly improved rules of conduct and trading procedures. For instance, after World War I, both the Chicago Board of Trade and the Chicago Butter and Egg Board – which in the meantime had renamed into Chicago Mercantile Exchange – established modern clearing-houses that assumed the role of central counter-parties, therefore drastically reducing default risk. Until then, futures had been settled through a procedure of multilateral netting amongst brokers (Markham, 2002*b*, 105-106). Second, after forty years since the emergence of futures markets, Federal regulation was finally implemented in four different moments: i) the Cotton Futures Act in 1916; ii) the short-lived Futures Trading Act in 1921; iii) the Grain Futures Act in 1922; iv) and, more importantly, the Commodity Exchange Act (CEA) in 1936. Let us examine the specifics of these regulatory frameworks.⁷⁸

The Cotton Futures Act was introduced in 1914 when the Department of Agriculture decided to set uniform grade standards for commodities. In fact, differences amongst cotton grades often caused disruptions in cotton trading. The Act imposed

⁷⁸Unless otherwise referenced, the analysis of these regulatory actions is based on Cftc (2011), Markham (2002*b*, 93-106, 214-225) and Swan (1999, 249-255).

a tax of two cents per pound of cotton sold. However, such tax was not to be levied if certain conditions were met. The contract should specify the grade, type, sample, the price per pound, the time of shipment and delivery. More importantly, delivery could not be effected by setting off. In other words, the actual transfer was required. Challenged by a New York district court in 1914, a new statute was then enacted in 1916.

Further regulatory actions in futures trading were interrupted at the outbreak of World War I. During the conflict, commodity prices were controlled by the Food administration under the direction of Herbert Hoover. Once restrictions were lifted at the end of the conflict, prices as well as the value of land dropped. Such decline was exacerbated by the heavy farm debt which had increased rapidly since 1910. In particular, the drop in wheat price was marked by speculative attacks which prolonged for ten months. These events encouraged both the Federal Trade Commission and the Department of Agriculture – under request of President Woodrow Wilson – to open an investigation of the grain trade. The seven-volume-long report thoroughly examined the grain industry, including the role of futures markets. The conclusions were that futures helped the efficient allocation of resources, but regulatory efforts were necessary to eliminate abuses which artificially affected the prices.

After the investigation, congressional hearings began and led eventually to the adoption of the Futures Trading Act of 1921. The latter introduced a tax on all contracts that are traded outside specific exchanges (contract markets) which are designated by the Department of Agriculture. Furthermore, in order to avoid market manipulations, full disclosure and record keeping was introduced for large trading operations. However, the Supreme Court declared in 1922 that the Futures Trading Act was unconstitutional due to an improper use of taxing powers by the Congress. After only two weeks from this decision, wheat was again subject to sudden price manipulations. As a result, authorities were fast in replacing the Futures Trading Act with an amended version: the Grain Futures Act. This time, the latter was enacted in line with Congress' constitutional powers regarding commercial activities. It banned, rather than taxed, futures stipulated outside designated contract markets. Moreover, the Grain Futures Administration was formed as an agency within the Department of Agriculture to supervise the Grain Futures Act. Finally, the Grain Futures Commission was instead established and consisting of the Secretary of Agri-

culture, the Secretary of Commerce and the Attorney General. The Commission had power to suspend or revoke the designation of a contract market. In spite of these reforms, several manipulations of commodity markets continued to occur during the 1920s.

In the meantime, the American economy witnessed the gradual growth of multinational companies, the interests of which clashed with the isolationist and procyclical policies put forward by the Republicans and the above-mentioned system of 1896. The capital-intensive nature of their investments allowed these companies to better manage industrial relations, an aspect which was attuned to the demand for social reforms and consumerist aspirations of the American masses. What is more, investment bankers such as Goldman Sachs and Kuhn, Loeb & Co. associated their business to these multinational companies, becoming increasingly dissatisfied with the J. P. Morgan-centred trust. Once the crisis of 1929 broke out, this foreign-oriented capital bloc and their bankers played a crucial role in supporting the New Deal reforms advanced by Franklin Delano Roosevelt and the Democratic Party (Konings, 2006, 115-117).

The Great Depression inaugurated a period of congressional hearings as well as attempts by the authorities to stabilise commodity prices, which by that time reached such historic lows that crops were in surplus whilst many people suffered of hunger (Rochester, 1940). Initially, the 1929 Agricultural Marketing Act and the Federal Farm Board sought to increase prices by buying commodity surpluses and holding them off the markets. In spite of these efforts, commodity prices continued to plunge. It was in this context that the Roosevelt administration sought to implement a form of regulation which, whilst recognising the importance of commodity exchanges, would also attempt to regulate these arenas by limiting speculative operations. Since futures primarily concerned agricultural and commodity markets, these instruments fell under the agricultural committees in Congress. The result of the hearings was the 1936 Commodity Exchange Act which represented the basic statute of US futures regulation. Commodity market regulation mirrored the 1934 Securities Exchange Act (1934) which provided the regulatory framework for financial markets, establishing also the SEC as the regulatory agency.

The Commodity Exchange Act replaced the 1922 Grain Futures Act by advancing some important innovations. First, it extended Federal regulation to a list of

commodities such as cotton, rice, mill feeds, butter, eggs, and Irish potatoes, as well as grains. Second, the Commodity Exchange Commission substituted the Grain Futures Commission, but still consisted of the Secretary of Agriculture, the Secretary of Commerce and the Attorney General. The Commission was granted the authority to establish Federal speculative position limits. Day-to-day control over futures operations were handed to the Commodity Exchange Administration, later renamed Commodity Exchange Authority. Third, futures commission merchants such as brokerage firms were required to register with the Department of Agriculture and to deposit customer funds for margin purposes. Fourth, all commodity options were banned. This law remained in effect until 1981. Options were deemed to fuel speculation by giving traders the right to buy or sell commodity futures. Whilst the commercial validity of futures was accepted, options on futures were controversial since they involved only the right to buy or sell futures (Geisst, 2002, 19). For what concerns stock options instead, these fell under the regulation of the SEC and, up until the creation of the Chicago Board Options Exchange (CBOE) in 1973 (see next section), they were traded on a small informal market in New York.

2.2 American finance and the management of financial risk

To recapitulate, the previous section has examined the origins of commodity futures trading, the power relations, as well as the institutions and discourses out of which futures were recast as legitimate practices of risk management. After this, the last part of the section has reviewed the Federal regulatory actions which consolidated futures markets as an important dimension of the American economy. The practices of futures isolated speculation from gambling and became functional to manage business risks. In this context, even hedgers had to go long or short in a speculative guise.

The present section looks at how and why the idea of derivatives-based risk management was applied to the world of finance. It begins by introducing derivatives during the post-war period. In these years, trading was hindered by low price volatility and involved mostly commodity futures. Financial derivatives such as stock options and warrants were relegated to the margins of American financial markets.

After this, the analysis focuses on two agential initiatives which – against the initial hostility of the American establishment – worked together to reinterpret the idea of risk management into a powerful innovation for financial investors. First, the analysis looks at the CBOT and Merc with their activities of lobbying for the introduction of stock options and currency futures on organised exchanges. Then, it examines how financial economists legitimised the quest for financial derivatives at a theoretical-discursive level. Finally, the study explores the expansion of American finance at home and abroad during the post-war years. This aspect facilitated the agential power of commodity exchange officials and economists in launching financial derivatives on organised markets.

2.2.1 Derivatives in the post-war period

The New Deal reforms did not question the existence of futures trading. Yet, the latter nonetheless operated in an adverse scenario. To begin with, government guaranteed a minimum floor for commodity prices, whilst a surplus in agricultural produce prevented such prices from increasing much (Cochrane, 1993). Second, policy-makers put forward commodity price stabilisation schemes as an equitable way to secure stable prices for both producers and consumers (Gosh, Gilbert and Hughes-Hallet, 1987; Newbery and Stiglitz, 1981). As a result, this situation of relatively stable markets considerably decreased price volatility, that is the *raison d'être* of futures markets. The case against speculation on commodity exchanges was further reinforced by the authorities imposing high margin requirements, as well as amending the Commodity Exchange Act to account for newly regulated commodities. For instance, in 1949, fats and oils, cottonseed and cottonseed meal, peanuts, soybeans and soybean meal were included in the statute. Wool was added instead in 1954 and onions in 1955. Yet, Congress could hardly keep up with the expansion of futures. Hence, many commodities remained unregulated, opening up loopholes to be exploited for speculative purposes (Markham, 2002*b*, 323-324). In fact, several remarkable episodes alerted the authorities and filled newspaper headlines. The most sensational one occurred in 1955 and came to be known as the onion corner.

Onion futures started to be traded at the Merc in the mid-1940s when the exchange was trying to find a profitable alternative for butter futures. Ten years after, onions became the fastest-growing contracts at the Merc. However, few producers

and dealers controlled the market which was also characterised by an inelastic demand. In other words, onions represented the perfect arena for a so-called market corner (Greising and Morse, 1991, 80-82). Corners are attempts by a trader (or a group of traders) to control the deliverable supply of the underlying good, whilst at the same time going long on a large futures position. Once traders secure the supply of the underlying commodity, those in a short position would find it difficult to deliver the asset. In this case, the ‘shorts’ are forced to settle their contracts with the ‘longs’ at inflated prices (Kolb and Overdahl, 2007, 59).⁷⁹ After the Commodity Exchange Act listed onions in 1955, authorities began investigating the New York-based dealer and onion grower Vincent W. Kosuga and Sam S. Siegel, a Merc-trader who also owned a produce company in Chicago. The evidence about the onion market being cornered was striking to say the least. In March 1956, onions were sold at less than the cost of the bags in which these vegetables were shipped (Markham, 2002*b*, 324). Once the investigation was concluded in June 1956, the authorities charged Kosuga and Siegel with the accusation of market manipulation. In August 1958, Congress passed the Onion Futures Act which banned onion futures trading. The ban still remains in effect today (Cftc, 2011).

The ban caused enormous losses to the Merc. It brought the exchange to near-terminal conditions since onion futures were by far its most dynamic products. However, the defeat prompted the exchange to look for new lucrative contracts. In fact, these were found in frozen pork bellies, live cattle and frozen concentrate orange juice, respectively introduced in 1961, 1964 and 1968. The very same year in which orange juice futures were launched, the Commodity Exchange Act was amended to add these new products to the list of regulated commodities as well as to increase its enforcement provisions. Yet, in spite of its amendments, the Commodity Exchange Act left open many regulatory gaps which speculators exploited, particularly at a time in which inflationary pressures made commodity prices unstable. For this reason, congressional hearings proposed a new legislation to regulate commodity futures trading (Markham, 2002*c*, 41-46).

On October 23-24, 1974, Congress passed the Act which established the Commodity Futures Trading Commission, overhauling the Commodity Exchange Authority and obtaining greater powers than its predecessor (Cftc, 2011). CFTC were

⁷⁹In the early years of the CBOT, corners were popularised by legendary traders such as Benjamin ‘Old Hutch’ Hutchinson. See Geisst (2002).

given jurisdiction not only on commodity derivatives but also on “all other goods and articles [...] services, rights and interest in which contracts for future delivery are presently or in the future may be dealt in” (Green et al., 2005, 14/72). This comprehensive definition came to be crucial at a time in which a revolution in derivatives trading had already begun. In fact, soon before the establishment of the CFTC, CBOT and Merc officials had successfully lobbied the American establishment for the introduction of financial derivatives on organised exchanges. The events had brought into being the International Monetary Market (IMM) in 1972 and the already mentioned CBOE in 1973. Here, traders dealt respectively in currency futures and stock options. American banks and institutional investors soon embraced these innovations in derivatives trading to manage their risk exposures. Financial derivatives were about to take the centre stage in the realm of risk management.

Representatives of both the CBOT and Merc exerted considerable agential power in advancing their expertise to the needs of financial investors. But, their agency was helped at a discursive level by the growing academic discipline of financial economics. In spite of their legendary semi-feud (Malkiel, 2011), both practitioners and academics worked together in emancipating derivatives from their commodity basis. Let us see these two forces in action.

2.2.2 The Chicago Board Options Exchange and the International Monetary Market

The use of options in the United States developed over the course of the nineteenth century, but remained limited to informal activities occurring outside organised exchanges. As previously mentioned, the New Deal reforms banned options on commodities, whilst a small New York-based market for stock options passed under jurisdiction of the SEC. During the post-war decades, put-call dealers advertised options in the pages of *The Wall Street Journal* and *The New York Times* (see figure 2.2). Investors would phone these dealers to buy options which expired a specified number of days from transaction. The strike price was instead the current price of the underlying stock at contract expiration. If an investor wanted to close out the position before expiration, she had to refer back to the put/call dealer who charged prices which well reflected a market under monopolistic conditions (Cboe, 1995, 6-7). The activities on such a small over-the-counter market hardly redeemed

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Low Rubber	28½	Aug. 31	250.00
General Motors	82½	Aug. 18	275.00
Admiral	28½	July 20	200.00
Western Airlines	34½	Aug. 25	200.00
Trans World Airlines	22½	Dec. 8	375.00
Raychem	27	Aug. 24	200.00
U. S. Rubber	65½	Sept. 4	575.00
Raymond Tobacco	52½	Aug. 24	225.00
John Morrell	28	July 22	225.00
Amer. Stand. Radiator	18½	Nov. 17	227.50
Gen'l Elec. Equip.	38½	Aug. 31	325.00
Amer. Steel Foundry	84	July 27	400.00
Cashley Packing	13½	Nov. 30	225.00
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N.Y. Central RR Co.	30½	Aug. 28	425.00
Singer Corp.	35	Aug. 31	375.00
Raytheon	56	July 30	475.00
American Motors	37½	Dec. 7	525.00
Chrysler	72	July 27	675.00
Chance Vought	36	July 27	425.00
Boech Aircraft	40	July 20	425.00
Sperry Rand	28½	Aug. 25	325.00
Boeing Airplane Co.	37½	Dec. 2	400.00
Revlon	58	July 23	525.00
Minneapolis Moline	25½	Aug. 25	250.00
Great Atlantic & Pac	43½	Dec. 2	375.00
Harris Intertype	51½	Aug. 17	600.00
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Figure 2.2: Advertisement for the options dealer Filer, Schmidt & Company, 1959.

The left column (call options) is taken from *The New York Times*. The right column (put options) is instead taken from *The Washington Post*, both of June 2, 1959. Source: Filer, H. (1959), *Understanding Put and Call Options*, cited in Cboe (1995, 7).

options from the numerous abuses they had been involved during the 1920s (Poitras, 2002, 42). After the 1929 market crash, options were seen with widespread hostility and they were relegated to the margins of American finance.

But, in many respects, options continued to fascinate the minds of the most attentive market practitioners and financial theorists. For these people, the abuses and frauds which surrounded options were not enough to discard one intrinsic aspect of these instruments: the ability, for a small fee, to allow the investor to benefit from favourable market trends, whilst opting out from the adverse outcomes. It was this peculiar characteristic – in those days, strongly supported by financial economists (see next subsection) – which drew the attention of one important trader at the Chicago Board of Trade, Edmund O'Connor. He thought of trading options on the Chicago pits rather than the small over-the-counter market in New York. After initial objections, the President of the Board Henry H. Wilson and his assistant Joseph W.

Sullivan received this idea favourably. In those days, Sullivan was evaluating new business possibilities to revive trading volumes which were at historically low levels. But, all these strategies encountered numerous cultural, political and legal problems and were therefore abandoned (MacKenzie and Millo, 2003, 112-114).

In 1935, the SEC had granted the Chicago Board of Trade a license to register as a securities exchange. This meant that, although CBOT never took advantage of this opportunity, the organisation was nonetheless allowed to trade corporate shares and not just commodity futures (Cboe, 1999, 9). Yet, the intention of the exchange officials was not to trade shares but stock options. Undoubtedly, this project was going to face great resistance by the establishment.⁸⁰ In fact, then SEC Chairman Michael F. Cohen – once invited by Wilson and Sullivan for a meeting – compared options to Thalidomide, a sedative which was discovered to cause birth defects. Against this opposition, CBOT looked for an economic justification in support of an organised options market. This came from a report prepared by the leading consultancy firm Nathan Associates in 1969. Industry leaders, influential investors and academics such as Burton Malkiel, William Baumol and Richard Quandt provided analyses to the report. The concluding argument was that the US economy would have considerably benefited from an options exchange. After the Nathan report was released, CBOT recruited the prominent security lawyer Milton Cohen to lobby the SEC for the options case. But, the proposal made very slow progress and after two years no approval was in sight. In 1971, options finally received positive attention once the Nixon administration appointed William J. Casey as the new Chairman of the SEC. As a pro-market corporate lawyer, Casey held Milton Cohen in high esteem and favoured the arguments in support of the options exchange despite widespread scepticism amongst staff at the SEC. In this scenario conducive to market-oriented practices, the CBOE opened on April 26, 1973. The exchange organisation and the listed contracts were modelled on the same standards of commodity futures trading at the CBOT.

In the same years when the Chicago Board of Trade advanced the case of standardised options trading, representatives of the Chicago Mercantile Exchange were also exploring new trading opportunities.⁸¹ Leo Melamed, a law-educated trader who

⁸⁰The following analysis concerning the CBOT's plan to establish an organised options exchange is based on MacKenzie (2006, 149-150).

⁸¹Unless otherwise referenced, the following description is based on MacKenzie (2006, 147-150,

became Chairman of the exchange in 1967, was thinking about futures on a stock index such as the Dow Jones industrial average or the Standard & Poor 500. After these ideas clashed with the current political, cultural and legal climate, Melamed switched to another project: futures on currencies. The case for currency futures was certainly easier to achieve compared to options. Although related to a monetary asset as the underlying, these instruments worked within the boundaries of the doctrine of contemplating delivery. Furthermore, the prominent economist Milton Friedman (1953) – who had for a long time argued in favour of an international monetary system based on flexible exchange rates – strongly supported the possibility of using currency futures. Over a dinner with Melamed and Merc’s President E. B. Harris, Friedman agreed to write a paper in support of a futures market in currencies.⁸² This was published in December 1971, four months after Nixon had closed the dollar-gold parity on which the Bretton Woods monetary system was based. At this point, although Merc’s lawyers advised to proceed without government approval, Melamed and Harris did so carefully and first made appointments with decision-makers to seek favourable opinions. Most notably, Secretary of the Treasury George P. Shultz – who had been a colleague of Friedman at the University of Chicago – put it in very simple terms: “if it’s good for Milton, it’s good enough for me” (Melamed and Tamarkin, 1996, 195). Hence, the International Monetary Market started its trading operations on May 16, 1972.

The next subsection presents the academic discipline of financial economics as a vehicle of discursive power supporting the creation of the CBOE and the IMM. As already mentioned, pro-market economists such as Friedman, Baumol, Malkiel and Quandt provided their direct contribution through policy-oriented reports in support of the exchanges. Besides their specific efforts, financial economics and options pricing theory played a crucial role in creating the wider intellectual milieu for financial derivatives to gain legitimacy. Indeed, economists from American universities and research centres isolated the risk deriving from price volatility as the fundamental element of the investing science (Wigan, 2008, 2009). To begin with, portfolio theory quantified and priced risk in order to help investors diversify away unnecessary risks whilst being rewarded for their asset exposure to movements of the market as a whole. Then, partly on the basis of these achievements, options pricing

170-174).

⁸²Recently, *Cato Journal* has re-published the paper. See Friedman (2011).

theory advanced the possibility to eliminate any type of risk through options. Let us explore the subject more in details.

2.2.3 Financial economics: isolating the risk of volatility

Until the 1950s, business schools taught the subject of finance in a very descriptive manner. A typical course module would primarily focus on the corporation as a legal entity, the various financing arrangements and investment strategies (MacKenzie, 2006, 37-38). The subject matter was “little more than a collection of anecdotes, rules of thumb, and shuffling of accounting data” (Merton, 1998, 323). Early statistics-based contributions – such as the theory of speculation which the French physicist Louis Bachelier (1900) pioneered at the turn of the twentieth century – were simply ignored. However, this intellectual scenario which was adverse to mathematical modelling began to change over the course of the 1950s and 1960s. At that time, a small group of economists – most notably, Franco Modigliani, Merton Miller, Harry Markowitz, William Sharpe, Eugene Fama, Paul Samuelson, Fischer Black, Myron Scholes, and Robert C. Merton – began to develop sophisticated theories of financial markets.⁸³ Following a direct lineage from Bachelier’s work, these scholars assumed that market prices move in a random and unpredictable fashion, a phenomenon which was popularised as *random walk hypothesis* (Cootner, 1964; Malkiel, 2011). Markets process data and promptly adjust to their casual arrival. Due to the randomness through which new information approach the market, it is impossible to predict future trends consistently and make above-average profits in the long run.⁸⁴ This meant that both technical and fundamental analysts were mistaken in their attempts to forecast market forces.⁸⁵

Hence, rather than forecasting the future on the basis of hunches, investors should deploy the instruments of modern statistics to express the probability of downward or upward movements in prices. These innovative ideas formed a theoretical corpus known as financial economics, a mathematics-intensive discipline which came to dominate the field of finance and marginalised any descriptive approach. In the

⁸³For a history of these scholars and their ideas, see Bernstein (1992, 2007) and MacKenzie (2006).

⁸⁴This was the core tenet put forward by the Efficient Market Hypothesis (Fama, 1970).

⁸⁵Technical analysts study charts of past price variations in the attempt to forecast future market trends. Fundamental analysts examine instead companies’ balance sheet, cash flow reports and income statements to estimate the intrinsic value of companies shares. See Malkiel (2011).

first instance, the mathematisation of finance caused many perplexities. Market professionals fiercely opposed the models put forward by financial economists. In particular, they rejected the random walk hypothesis as a challenge to their overly remunerated ability to ‘beat’ the market by anticipating its trends (Malkiel, 2011). However, over the course of the 1970s and 1980s, financial economics gained great attention and its theoretical achievements breached initial resistance. For instance, the Beta coefficient – the core parameter of the capital asset pricing model (see below) – became orthodoxy amongst financial investors (Bernstein, 2007). What is more, the Black-Scholes options pricing model was adopted as the standard method to evaluate options at the Chicago Board Options Exchange and other options markets (Cboe, 1999, 11).⁸⁶

As practitioners adapted the ideas developed by financial economists to the trading rooms, the concept of risk appeared as the most important element to be considered in every investment strategy. In turn, the significance of risk gave legitimacy to financial derivatives as the instruments which are essential to manage such risk efficiently. Why did financial economists place so much attention to risk? And, more simply, what is risk?

2.2.3.1 Markowitz’s portfolio theory and Sharpe’s capital asset pricing model

A key issue facing investors is how to allocate funds amongst alternative assets. Markowitz (1952) addressed this problem through his *portfolio theory*.⁸⁷ He argued that investors hold those assets that are expected to provide maximum returns for a given level of risk – or the minimum risk for a given level of returns. In other words, expected returns are not the only relevant aspect to consider when buying an asset. Risk is also important. And a trade-off between risk and return exists, according to which an investment can give higher profits only if it is subject to the probability of being lost.

Markowitz expressed the expected return on an asset as the probability of its *mean return* over a given period of time. He defined instead risk as the probability

⁸⁶The use of this innovation was not as immediate and widespread as it is often believed. See MacKenzie (2006, 156-164).

⁸⁷Unless otherwise referenced, the following analysis on portfolio theory and the capital asset pricing model is based on Bodie, Kane and Marcus (2008, chapter 5, 6, 7) and Howells and Bain (2005, chapter 8).

that the actual return on an asset varies from the expected return – both in excess or as a loss. Risk is measured by the *variance* and its square root, the *standard deviation*. In simple terms, these two statistical measures show the extent to which the expected return on assets vary from its mean return, indicating higher or lower asset-price volatility.

The importance of Markowitz's theory was that investors could efficiently combine assets in a portfolio with the aim of obtaining a given expected return whilst reducing the exposure to risk. How is this possible? The answer is portfolio *diversification*. It implies two fundamental aspects: first, as it is obvious, the expected return of a portfolio is given by the weighted mean of the expected returns of all the assets included in it. Second, for what concerns risk, this is measured not only through a weighted mean of the variances of each asset's expected return included in the portfolio. But, the formula contains also the *covariance* of expected returns amongst the assets, a statistical tool which measures the degree to which the expected returns on each assets vary together.

Covariance – which includes the so-called *correlation coefficient* – is crucial to comprehend the importance of portfolio diversification. For instance, two assets with high variance would be risky if held in isolation. But, if the investor builds a two-assets portfolio, and these two assets are less than perfectly correlated, the portfolio return could be held constant. The two assets would be combined in a way that if the return on one asset goes up, the return on the other asset goes down. In other words, the variations of the two assets would cancel each other out, reducing the risk exposure of the overall portfolio. By using the same logic to diversify a portfolio of twenty and more assets, returns would be optimised for a given level of risk.

However, continues Markowitz, there are two types of risk:

- *unsystematic risk*, which is the risk specific to each assets such as news about individual companies;
- *systematic risk*, that is the risk to which all assets are commonly exposed, such as recessions or interest rate changes.

By holding a well diversified portfolio, investors can cancel the effects of unsystematic risk but not systematic risk. This second risk relates to economy-wide events which expose all the portfolio assets to a higher probability that actual returns differ from

what was expected. Systematic risk bears important implications in terms of return on assets to the extent that it represents the only relevant risk to be taken into consideration. Investors should be rewarded for assuming this risk, reflecting how much the assets included in their portfolio are subject to the vagaries of economy-wide events.

After Markowitz's work, Sharpe (1964) built on this point to develop the capital asset pricing model (CAPM) which addresses two intertwined questions: how is systematic risk for a given asset measured? How is this risk priced? CAPM helps investors calculate what returns on assets they should expect on the basis of their exposures to systematic risk. If the expected returns do not equal or exceed the required return, they should not undertake the investment. According to CAPM, the return on an asset equals the risk-free interest rate – for instance, of a three-month US Treasury bill – plus a premium that a given investor requests as a compensation for the extra risk she takes. This risk premium consists of two elements. First, the *equity market premium*, which is the expected return of the market as a whole. In the case of the stock market, this expected return of the whole market is established by using the returns of an all-share index less the yield on the risk-free interest rate. The all-share index is an approximation for a miniature portfolio which contains all the risky assets available on the market. This is used as the greatest degree of diversification which leaves the miniature portfolio exposed only to the risk of the market itself – that is, systematic risk. In this regard, the equity market premium gives a price to systematic risk.

Second, given the benchmark price of the equity market premium, it is then necessary to know how much of this price should apply to any individual asset. In other words, this is the quantity of market risk embedded in a given asset. It is found by comparing the variance of returns of the individual asset with the variance of returns of the whole market portfolio (the all-share index). Using a statistical technique known as regression line, the return on the asset and the return on the whole market portfolio are plotted on a graph. Sharpe defined the slope of the regression line as the *beta coefficient*, which indicates the asset's exposure to systematic risk. Beta measures the relative volatility of a given stock compared with the volatility of the stock market as a whole. When a share price moves exactly in line with the stock market, it means that the stock's beta equals 1. If beta is greater than 1, it

means that the share price is more volatile than the market. When beta is instead less than 1, it indicates that the stock is less volatile than the market. Beta 0 indicates a theoretical situation in which the share price remains unchanged regardless of which direction the market moves.

What is the significance of both Markowitz's portfolio theory and Sharpe's capital asset pricing model for the purposes of this thesis? Markowitz and Sharpe galvanised the quest for financial derivatives as fundamental sites of risk management for financial investors. Both scholars isolated risk and price volatility as the most significant elements in every investment decision (Wigan, 2009, 161-163). Their ideas unleashed a radically new way of thinking about financial markets and investments. They transformed finance into a science which sees investments as bets on an uncertain future and subject to the randomness of chance. For this reason, modern statistics was adopted to control the risk which such randomness entails. In a word, as this process of theoretical building unfolded, *risk and the management of a varieties of risks appeared as the quintessential determinants of investment success* (Bernstein, 2007, xiii-xiv, xvii). At this point, economists increasingly looked at derivatives – in particular, options – as instruments that could help investors erase their portfolio's exposures to market risk. Let us now look at options pricing analysis.

2.2.3.2 The Black-Scholes-Merton pricing formula for a call option

During the post-war period options and warrants were valued following simple rules.⁸⁸ There was no theoretical basis for establishing the prices at which these instruments were bought and sold. However, economists at the Massachusetts Institute of Technology (MIT) were becoming increasingly attracted by the idea of establishing scientific rules for valuing options and warrants (Bernstein, 1992, 206-207). Many scholars already attempted to provide a formula to calculate the fair value of options, but all these works were dependent on parameters that were hard to estimate (MacKenzie, 2006, 119-127). The most innovative steps towards an options pricing formula were taken by Black and Scholes who met at the MIT Sloan School of Management in 1968 and began collaborating with Merton in 1970.⁸⁹

⁸⁸Unless otherwise referenced, the following study about options pricing is based on Kolb and Overdahl (2007, chapter 13), Hull (2009, chapter 13), Bodie, Kane and Marcus (2008, chapter 16).

⁸⁹For the history of how Black, Scholes and Merton reached their conclusions, see Black (1989), Scholes (1998), Bernstein (1992) and MacKenzie (2006).

The Black-Scholes-Merton model involves substantial mathematical and statistical background, an aspect which is beyond the purposes of this thesis. Yet, the logic behind the model can be explained in simple terms. The formula for a European call option on a stock is the following:

$$C = SN(d_1)Xe^{-rT}N(d_2) \quad (2.1)$$

d_1 and d_2 are obtained through

$$d_1 = \frac{\ln(S/X) + (r - \delta + \sigma^2/2)T}{\sigma\sqrt{T}}$$

$$d_2 = d_1 - \sigma\sqrt{T}$$

where

S=stock price

X=exercise price

r =risk-free interest rate

σ =stock volatility

T=time expiration of the option

δ =annual dividend yield of the underlying stock (assumed to be 0)

e =the base of the natural log function

$N(d_1)$ and $N(d_2)$ =cumulative normal probability distributions

\ln =natural logarithm function

According to the formula, the options price is a function of five factors: the underlying stock price (\uparrow); exercise price (\downarrow); time to expiration (\uparrow); the volatility of the underlying stock price (\uparrow); the risk-free interest rate (\uparrow).⁹⁰ These are all known parameters except one: volatility. For this reason, traders use historical data to have an idea of the level of volatility, or they derive the so-called *implied volatility* from a premium already quoted by getting the Black-Scholes-Merton model to ‘work

⁹⁰Arrows indicate how an increase in each variable affects the value of the call option.

backward'. Once obtained the implied volatility, all the data can be inserted in the formula to easily get the fair value of the option. What is more, due to an equation known as the *put-call parity* relationship, it is easy to get to the price for a put option from the value of the call option.

What does the formula entail with regard to risk? The formula represents the most widely known solution to the differential equation which describes a portfolio made of a short position in the call option C with price $C(S, t)$ hedged at time t by purchasing $\Delta C / \Delta S$ number of stocks against the call option C . In practical terms, this hedged portfolio – consisting of a short position in the option and a long position in Δ shares of the underlying stock – eliminates risk through no instantaneous linear exposure to movements in the stock price S . This lack of instantaneously linear exposure needs continuous adjustments through *dynamic hedging*, which means revising the combination of call options and stocks (Derman and Taleb, 2005, 324). In so doing, the hedged portfolio provides the risk-free interest rate, a condition which is maintained by arbitrage trading.

Hence, dynamic hedging allows to protect from the stock-related risk constantly. Accordingly, the options pricing formula calculates the price of the option which gives the combination of stocks and options that secures the risk-free condition (Bernstein, 1992, 218). With the help of options, it is possible to create a portfolio which not only eliminates beta but also sigma, that is the variance of return on the hedged portfolio (Merton in MacKenzie 2006, 136). This astonishing theoretical achievement provided the mathematical rationale to boost options trading and, more generally, derivatives. As De Goede (2005, 131) notices, people believed that the more they traded the better off society was going to be as a result of the decrease in global risks. In sum, the Black-Scholes-Merton formula – as well as the ensuing options pricing models which either simplified methodologically or accounted for aspects that Black, Scholes and Merton did not considered initially – legitimated the post-Bretton Woods expansion of derivatives by arguing that these instruments reduce the risk of society at large.

2.2.4 The internationalisation of American finance

This section has thus far shown how representatives from the CBOT and the Merc – together with financial economists and their theoretical insights – revolutionised

the hostile common sense about financial derivatives. These actors transferred the long-established techniques of commodity futures trading to the world of finance by launching stock options and currency futures on organised markets. Initially, CBOT and Merc officials faced great hostility to their business ideas. But, soon the political-economic and cultural opinions in Washington and New York turned in their favour. What were the reasons which brought this shift in the American establishment? This final subsection shows that, at a time when the global glut of non-resident dollars weighted dramatically on the US balance-of-payments position, decision-makers realised that American banks had developed international linkages which enhanced the ability to sell dollar-denominated debt to other countries. In so doing, the deficit in the US balance of payments gradually lost its importance, allowing the Nixon administration to end the convertibility of dollars into gold without causing major disruptions (Gowan, 1999; Konings, 2008*c*; Panitch and Gindin, 2008). These financial and monetary dynamics were fundamental in creating the political-economic scenario conducive to the consolidation of financial derivatives. The present study focuses on the period from the 1960s until the collapse of the Bretton Woods monetary system in 1971. The next section examines instead the expansion of derivatives-based risk management and its significance for American financial power during the 1970s and 1980s.

After World War II, American financial actors were in full swing and hardly limited by an international monetary system attuned to the objectives of full employment and national economic growth. As Konings (2006, 2008*c*, 2009) shows, commercial banks expanded mortgage securities and consumers loans. In so doing, they permeated the very fabric of society and implemented a form of welfare state which heavily depended on financial markets in comparison to its European counterparts. Furthermore, banks complemented their practices of asset-side securitisation – already undertaken since the nineteenth century through the market for call loans – with techniques of liability management which securitised the deposit base. Particularly important in this regard was the creation of secondary markets for certificates of deposit (CDs). These were credit instruments through which depositors agreed to leave funds on deposit at the bank for a given period of time and interest rate. Commercial banks innovated these instruments by transforming them into negotiable money-market instruments which were issued in large denominations and traded on

secondary markets to increase their liquidity (Sylla, 2002, 60). For what concerns investment banks instead, these had been cut off from commercial-banking activities since the 1933 Glass-Steagall Act. But, in spite of these regulatory barriers, they developed leading strategies in project financing and the issuing of bonds for corporations, governments and international organisations (Smith, Walter and De-Long, 2011, 53). As it is clear, contrary to what is commonly assumed by Marxist, Régulationist and post-Keynesian approaches to financialisation, American banks developed financialised practices well before the 1970s. In fact, the current growth of finance could only occur on the basis of institutions and discourses which “pre-dated and indeed precipitated the disintegration of Bretton Woods” (Konings, 2008*b*, 258).

Over the course of the post-war period, as the American state constructed hegemonic linkages with other capitalist nations in the spheres of trade, production and security, both investment and commercial banks expanded their operations abroad accordingly. They followed American corporations in their European business and, in so doing, they began to influence the social formations of other countries (Panitch and Gindin, 2008, 24). In this regard, the Eurodollar market was fundamental in expanding the influence of American finance outside the US domestic markets. In 1957, after the Bank of England imposed limits on the use of the sterling pound to finance international transactions, London-based financial institutions began offering credits and deposits denominated in dollars (Burn, 2006). This offshore market soon turned very profitable and started to pool the large mass of non-resident dollars (dollar glut) that was floating around the world in those years, causing problems to the US payment position.⁹¹ During the 1960s, American multinational corporations and banks were increasingly attracted by the Eurodollar market. They circumvented higher interest rates on domestic money markets through the rates and facilities offered to their branches offshore. In particular, US banks were free to exercise their strategies and innovative practices on the Eurodollar market with few regulatory restrictions, “putting an unmistakably American stamp on the re-emergence of private global finance” (Konings, 2008*c*, 47-49). Initially, these linkages created by American financial actors abroad constituted a problem for the US administrations in

⁹¹These dollars left the United States as a consequence of American imports, foreign investments and military expenditures abroad. For this reason, they overhung outside the control of the Treasury and the Federal Reserve. As mentioned above, this phenomenon came to be known as ‘dollar glut’.

their attempt to restrict the dollar glut. However, this internationalisation of American finance soon turned into a privilege. In fact, it provided the conditions for the Nixon administration to close the gold window and push the Western world from a gold-dollar standard to a 'pure dollar standard' (Gowan, 1999).

Nixon announced the end of the gold-dollar parity on August 15, 1971. Since its inception the Bretton Woods monetary system rested on fixed exchange rates and the US dollar as the vehicle currency. To be sure, the dollar was fixed to gold, but other member nations held dollars in their central banks as the official international reserve asset. In other words, the US dollar was as good as gold, and supposedly backed up by vast gold reserves in the vaults of Fort Knox. However, as Robert Triffin (1966) famously argued, the Bretton Woods monetary system was subject to a basic contradiction: the ability of the dollar to function as a vehicle currency decreased with its expanding circulation beyond the national markets. Indeed, in an international scenario where the dollar was the key currency, liquidity could only expand through a growing US balance-of-payments deficit. In other words, the system relied on US deficits to prevent an international liquidity shortage. This paradox implied that in order to curb speculation against an imminent dollar devaluation it was necessary to end US deficits. But, in so doing, the system would have faced an international liquidity crisis. One solution was the creation of a new international currency issued by the International Monetary Fund, which could play an additional role as a reserve currency. Special drawing rights, as they were called, were eventually adopted in 1969 but never significantly used. At this point, due to the dollar glut, the confidence in the convertibility of the dollar into gold reached its lowest levels. Initially postponed through negotiations with Germany and Japan agreeing not to convert their reserves into gold, the confidence crisis eventually escalated once France refused to accept any agreement. In the meantime, speculative attacks increasingly targeted the dollar. Hence, the US government faced the decision to either stop printing dollars or to end the convertibility of the dollar into gold. This last path was the one chosen by the Nixon administration in 1971 (Eichengreen, 1996; Solomon, 1982).

The United States advanced the pure dollar standard to enhance American structural power in the global economy (Gowan, 1999, 19). Nixon broke out of the old arrangements which constrained American control over international monetary af-

fairs. In so doing, the United States were no longer restricted by the discipline of the gold-dollar parity and the deficit in the balance of payments. The latter was not solved, but simply left unchecked. Nixon's intention was to push European and Japanese governments towards an important crossroad. They could have financed the US deficit by lending their dollar surpluses to the American economy – that is, buying US Treasury securities. Alternatively, they could have dumped their dollars on the foreign exchange market, therefore depreciating the relative value of the dollar and indirectly favouring US exports. Any of the two roads appealed to US interests (Hudson, 2003, 348-350). Under these circumstances, other countries gradually accepted to further accumulate dollar-denominated assets. After all, American financial markets and their London-based satellites were deep and liquid enough to attract foreign funds, providing also a good rate of return (Gowan, 1999, 24-25). The 1973 oil crisis further expanded the liquidity of New York and London markets through the recycling of petrodollars.⁹²

The end of Bretton Woods and the establishment of the pure dollar standard dramatically increased the influence of US financial markets and actors in the world scenario. It came into being what Peter Gowan (1999, 24) defined as the 'Dollar-Wall Street regime', a phenomenon which works in two directions. On the one hand, the centrality of the dollar reinforces US financial markets. The dollar is the world's vehicle currency, therefore "the great majority of states would want to hold the great bulk of their foreign currency reserves in dollars, placing them within the American financial system (or in London)." On the other hand, Gowan continues, there is also a feedback in the opposite way. The importance of American financial markets consolidates the hegemony of the dollar, "for anyone wanting to borrow or lend money, the size and strength of a financial system is a very important factor. The bigger a financial market's resources and reach, the safer it is likely to be" in terms of liquidity, portfolio diversification and competitive rates for borrowers.

How did these wider monetary and financial dynamics help the CBOT and Merc in their quest for financial derivatives? The growing centrality of American finance in the world economy considerably benefited the top managements of the two exchanges. Particularly, once the Merc's IMM and the CBOE were established, banks

⁹²The Nixon administration implemented this strategy through its diplomatic ties with Saudi Arabia as well as through the abolition of US capital controls in 1974. See Gowan (1999, 21) and Spiro (1999).

began to include derivatives in their domestic and global strategies. For instance, the introduction of currency futures at the IMM was a well-thought business which soon exploited the new regime of flexible exchange rates to a full extent. Options at the CBOE provided instead useful strategies to hedge the risk of stock-market volatility. The next section specifies the interaction between derivatives and American finance by looking at the expansion of these instruments as fundamental constituents of American financial power in its global construction.

2.3 Derivatives and American financial power

To recapitulate, the previous section has examined how and why derivatives were recast as instruments for the management of financial risks. The analysis has first shown the major developments on commodity markets during the post-war period. Successively, it has looked at the initiatives of CBOT and Merc in promoting stock options and currency futures. Their search for financial derivatives was strategically supported by financial economics, the theories of which emphasised risk as the central element of investing. In so doing, derivatives were transferred from commodity exchanges to financial markets and the risk implied by asset-price volatility. Finally, the section has explored the domestic and global expansion of American finance, particularly the modalities through which it provided a political-economic and cultural environment conducive to the business ideas of CBOT and Merc.

This final section looks at how derivatives-based risk management grew as part and parcel of American financial power in its global consolidation. The section is divided into two parts. First, it reviews the early years of derivatives until the Shad-Johnson Accord in December 1981. This period was characterised by numerous regulatory uncertainties within a political-economic scenario which failed to support American finance in its hegemonic potentials. The second subsection examines instead how the restructuring of the US economy in line with the dictates of American finance provided an institutional and discursive environment upholding the expansion of derivatives from the 1980s onwards. In this regard, particularly astonishing was the growth of the markets for swaps, index derivatives and asset-backed securities. It is at this point that derivatives practices began to be projected outside the US boundaries.

2.3.1 The early years of financial derivatives

As previously shown, Nixon and his entourage became aware of the seigniorage power that the United States could have exercised on the basis of the pure dollar standard. For this reason, Washington resisted any attempt to build another formal monetary regime, proceeding instead on the path of international monetary unilateralism. Over the course of the 1970s, the various US administrations allowed American finance to grow in size, liquidity and level of product innovation. Financial expansion enhanced the diffusion of American power by offering other societies “the most competitive terms [...] to borrow money” (Gowan, 1999, 33) and, in so doing, winning their consent in accepting dollar-denominated assets. However, throughout the decade, the construction of American financial power remained highly contradictory. In fact, as Panitch and Gindin (2008, 30) explain, the expanding financial markets were caught in a vortex of economic recession, labour militancy and accommodating monetary policy. Due to these problems, the authorities were unable to curb the double-digit inflationary pressures, the declining value of the dollar and the continuing outflows of capital. In other words, domestic institutions fell short of providing the proper environment for US financial markets to absorb global credit flows and, in turn, consolidate American financial power in world affairs.

This uncertain scenario produced a tension in the realm of derivatives. On the one hand, these instruments became integral to American finance and its expansionary trends. Banks continued on their path towards disintermediation by innovating their securitisation techniques. They moved from a model based on taking deposits and lending the funds, to one in which they mediate, for a fee, the interaction of security market participants, or engage in trading on their own account (Panitch and Gindin, 2008, 27-28). Once all items in the banks’ balance sheets were seen as securities with a certain level of risk and market volatility, derivatives emerged in all their risk-management significance. Through these instruments, banks mitigated their risk exposures to variable interest rates, floating exchange rates, as well as stock-market volatility – circumstances which also gave opportunities to profit from risk (Konings, 2006, 508-509). What is more, savings and loan associations, mutual funds and insurance companies joined banks in their derivatives strategies (Markham, 2002*c*, 89-90). Altogether, these financial actors gave a tremendous boost to the newly established CBOE, IMM and the other exchanges that introduced

derivatives on financial assets.⁹³ On the other hand, a rivalry emerged between the Securities Exchange Commission and the Commodity Futures Trading Commission over their respective jurisdictions. This regulatory battle demonstrated the absolute inadequacy of US derivatives regulation in the period. More importantly, it added further delays to the business plans of derivatives exchanges.

The key issue was that, as already mentioned, the CFTC obtained jurisdiction over both commodity and financial derivatives. The SEC saw this decision as an incursion in its realm and a battle immediately emerged over the decision by the CBOT to trade futures on the Ginnie Mae certificates in 1975.⁹⁴ The SEC objected to these contracts by arguing that they were securities, therefore to be considered under its jurisdiction. On the contrary, the CFTC argued that it had exclusive jurisdiction over all types of futures trading (Markham, 2002*c*, 81).

However, besides Ginnie Mae futures, it was particularly the Merc's proposal for index futures which came to be a contested territory between the two authorities. The issue was certainly trivial due to the fact that this instrument could only be settled in cash and, for this reason, it appeared as illegitimate compared to other contracts which at least 'contemplated' the delivery of an underlying asset. Yet, regulators were not particularly concerned about the gambling features of index futures. The SEC was instead opposed to the creation of this instrument due to the fact that it would have fallen within the CFTC's regulatory power despite mirroring an asset that clearly belonged to its jurisdiction (MacKenzie, 2006, 171-172).⁹⁵

In the end, authorities accepted the creation of an entirely cash-settled contract when John Shad of the SEC and Philip McBride Johnson announced a basic agreement known as the Shad-Johnson Accords in December 1981. The latter was enacted into law and established the respective responsibilities between SEC and

⁹³The American Stock Exchange (Amex) announced a plan to trade options in 1974. But, the SEC refused to allow Amex to begin trading options until both Amex and CBOE agreed on the development of a common clearing and settlement system as well as a jointly managed price-reporting system. Amex and CBOE agreed to use the CBOE Clearing Corporation – which was renamed into Options Clearing Corporation (OCC) – as the common clearing agency. They also used the newly established Options Price Reporting Authority (Opra) as a national market system which provided last sale information and options quotations. Hence, options trading was allowed to expand with other markets entering the business such as the Philadelphia Stock Exchange and the Pacific Stock Exchange (Markham, 2002*c*, 52-53).

⁹⁴After the creation of CBOE as its spin-off, CBOT began trading derivatives on its very own pits (Geisst, 2002, 209).

⁹⁵In this regard, the Merc argued that an index future did not represent a security since stocks were never going to be delivered. See MacKenzie (2006, 170-174).

CFTC concerning a variety of financial instruments. In brief, the SEC obtained exclusive jurisdiction over options on securities and index options. The CFTC had instead exclusive jurisdiction over all futures and options on futures, including index futures and options on stock index futures (Cftc, 2011; Markham, 2002*c*, 87).

By the time the Shad-Johnson Accords were agreed on, the American establishment recognised the importance of financial derivatives. In 1978, the Treasury and the Federal Reserve conducted a study to assess banks' growing use of futures. The report argued that futures markets were efficient tools for banks and their clients to manage the exposures to interest rate risk. Therefore, futures were beneficial and the widespread speculative trading was nonetheless useful in providing liquidity for hedging purposes and a more efficient pricing. In 1983, the FED also noted that, due to portfolio theory, futures contracts could be deployed to minimise portfolio risk and maximise portfolio returns. Finally, in 1984, the Congress commissioned a joint study to the CFTC, the SEC, the FED and the Treasury. The report found no evidence about the destabilising effect of futures trading on Treasury securities. Quite the opposite, futures were deemed to improve market liquidity (Markham, 2002*c*, 90).

2.3.2 Swaps, index derivatives and asset-backed securities

When these studies were published in the early 1980s, the United States had already taken a new political-economic course. The latter stabilised the above-mentioned contradictions which afflicted the US economy during the 1970s, namely: inflation, economic downturn, the declining value of the dollar and the outflows of capital (Panitch and Gindin, 2008, 30). The monetarist turn of the Federal Reserve, with the appointment of Paul Volcker as Chairman in the August 1979, was crucial to initiate this new trajectory. Contrary to what is commonly assumed, the squeeze in money supply and the sky-rocketing interest rate executed by the FED failed to stop the overgrowth of credit (Konings, 2008*c*, 54-55). Yet, in spite of monetarism not working according to its theoretical dictates, the FED was nonetheless successful in curbing inflation and rendering the national economic environment suitable to sustain a dollar-centred global order. In other words, the 'Volcker shock' adjusted the operations of the FED in order to create the institutional conditions – above all, the right balance of class forces – necessary for US finance to attract global

credit flows and, in turn, to enhance American power in world affairs (Konings, 2008*a*; Panitch and Gindin, 2008). In this regard, three intertwined aspects were fundamental.

To begin with, for what concerns inflation, the overgrowth of money ceased to apply intense pressures on the general price level since it no longer entered real economic circuits. Funds began instead to be redirected towards the financialisation of the US economy. In other words, real-growth inflation was contained whilst stimulating asset-price inflation (Konings, 2007, 161-162). Second, the high interest-rate condition attracted also large capital inflows towards domestic financial markets, fostering their liquidity and resulting in a dramatic increase in the foreign purchase of US debt (Frankel, 1988). Third, the high interest-rate scenario also dealt a blow to the declining manufacturing sector. Since the late 1960s, the latter was affected by a crisis of overproduction together with European and Japanese competitors (Brenner, 2006). After the Volcker shock, manufacturing corporations had all the incentives to ‘financialise’ by investing in financial assets rather than productive activities (Krippner, 2005) – except for the investments in the military-industrial complex, as well as the information and communications technology sector (Gowan, 2009, 24). Companies adhered to the praxis of downsizing the labour force and distributing earnings to shareholders (Lazonick and O’Sullivan, 2000). Under the auspices of the Reagan administration and its assault on trade unions, capital disciplined labour and reduced the workers’ share of national income (Davis, 1999). Accordingly, the American population borrowed more to maintain its way of life, expanding consumer debt and allowing finance to permeate the fabric of society (Hyman, 2011; Montgomerie, 2006).

In sum, the Federal Reserve initiated a stabilisation of the domestic economy in order to gain international confidence about the pure dollar standard. The United States aimed at playing the role of safe haven for global capital flows. They did so through liquid and innovative financial markets as well as an anti-inflationary commitment guaranteed by a subordinated working class (Panitch and Gindin, 2008, 34). Furthermore, the consolidation of American financial power – with its neoliberal discipline of labour – showed European societies a viable way to address its own class-based contradictions through the creation of a similar, although subordinated, space of finance-led accumulation (Bieling, 2003; Ryner, 2007). In other words, other

Western societies began to restructure their domestic institutions on the basis of financialised practices.

Under these circumstances marked by the prevalence of American financial practices and innovation in the world economy, the use of both financial and commodity derivatives exploded. Commodity derivatives trading benefited from the reintroduction of commodity options in 1981, which were banned since the New Deal reforms. Financial derivatives – especially the over-the-counter dimension – grew instead exponentially, well beyond the trading volumes of commodity derivatives. Three markets were remarkable in their expansion: swaps, asset-backed securities and index futures. Let us examine them in turn.

Governments had used contracts similar to swaps before, but private dealers began to be involved in swaps contracts extensively during the 1980s. Swaps emerged as an OTC market since the transactions were too large to be traded on a centralised exchange. Whilst initially investment banks and bank affiliates helped two parties in structuring the deals, soon these financial institutions realised the potentials of fee-earning and started acting as market makers (Geisst, 2002, 250). In 1985, they established ISDA to represent the industry (Isda, 2012). Over the course of the decade, swaps became the fastest growing derivatives sector. These instruments became a very useful way to hedge the risk exposures towards interest rates and exchange rates (Markham, 2002*c*, 192). What is more, custom-tailored swaps were the perfect unregulated instruments which companies “could use [...] to avoid regulation or to hide risks” (Partnoy, 2009, 47). Local municipalities joined the clientele too. One of these local governments, the London municipal borough of Hammersmith and Fulham, became famous for its big losses incurred between 1987 and 1989 (Hull, 2012, 439).

ABSs were popularised by the above-mentioned Ginnie Mae, a body which spun off from the Federal National Mortgage Association (Fannie Mae) in 1968. Ginnie Mae issued certificates that represented an interest in a pool of mortgages issued by banks and thrift institutions. Certificates were then sold to investors on secondary markets and were guaranteed by the federal government. Such practice allowed Ginnie Mae to obtain funds that it used for additional mortgages. The Federal Mortgage Corporation (Freddie Mac) and the Student Loan Marketing Association (Sallie Mae) also began to issue asset-backed securities. In 1984, the Secondary Mortgage

Market Enhancement Act opened a regulatory regime which gave a boost to the market for mortgage-backed securities. The originators were no longer governmental institutions but bank affiliates and SPVs which packaged and sold securities with no government guarantees. Furthermore, ABSs expanded to include other assets which generate income streams such as credit card payments, car loans and so on (Markham, 2002*c*, 50, 142-144). In sum, structured finance was in full swing and, in about a decade, would become one the most complex and fastest-growing derivatives segment.

Contrary to swaps and ABSs, index futures were exchange-traded derivatives. After the lobbying efforts by Melamed and the Merc, these instruments became very important instruments for institutional investors. They were widely used as part of *portfolio insurance*, a risk-management strategy created by two Berkeley-based economists Hayne Leland and Mark Rubinstein. Index futures and options allowed managers to hedge their portfolios against market downsides. They were particularly crucial in a context in which portfolio theory had become financial orthodoxy by encouraging investors to diversify their portfolios in line with the general market performance. In this regard, index futures popularised the methodology of *programme trading*, which involved the use of computer-based trading to buy or sell contracts according to either positive or negative changes in the market. Under declining market conditions, the gain on shorting the index futures would offset the loss on the stock portfolio. But, this strategy had dramatic consequences during the stock-market crash of the October 19, 1987. It developed into a self-fulfilling prophecy which pushed the market downwards as computers entered more and more sell orders (Bernstein, 1992, chapter 14).

In spite of the 1987 crash, both over-the-counter and exchange-traded derivatives became embedded in a pro-market regulatory regime by the early 1990s. The United States influenced a type of global regulation which aimed at managing, rather than eliminating, financial expansion (Konings, 2008*a*, 66). To be sure, regulators expressed concerns about the systemic risk posed by derivatives to the global financial system. But, as the 1988 Basel Accord demonstrated, banks' risk exposure towards on-balance and off-balance-sheet operations was managed by imposing weighed capital requirements of 8% minimum (Nabors and Oatley, 1998). What is more, many policy-makers agreed with the conclusions expressed by the Group of Thirty, a pri-

vate group of major financial institutions chaired by Paul Volcker. In an influential report entitled *Derivatives: Practices and Principles*, the organisation recommended no further regulation, but sound risk-management practices adopted by derivatives dealers through self-regulation (Group of Thirty, 1993; Markham, 2002*c*, 202).

In the last two decades, American finance pushed even further the process of financialisation. Banks increasingly based their operations on proprietary trading – as opposed to trading on behalf of their clients – and prime brokerage lending to institutional investors and structured investment vehicles (SIVs). These strategies of proprietary trading and prime brokerage were directed towards speculative arbitrage and the almost continuous creation of asset-price bubbles. The ability to engage in these practices was enhanced by overly leveraged balance sheets, as well as by the growth of the shadow-banking sector as a spin-off of the regulated system (Gowan, 2009). Derivatives became an organic part of this finance-led regime, particularly in their over-the-counter dimension. By the turn of the 2000s, OTC markets and products had grown several times their exchange-traded counterparts. These markets existed in an unregulated reality connecting the various trading floors of the major financial institutions (Schinasi et al., 2000). US regulation such as the 2000 Commodity Futures Modernization Act assured that OTC derivatives remained largely exempted from the supervision of both the CFTC and the SEC. The regulatory environment in the London-based offshore space was even more ‘light-touched’ than its counterpart on Wall Street (Engelen et al., 2011, 132). Here, the bulk of trading concentrated on interest rate and foreign exchange risks, but throughout the 1990s banks began to package also complex instruments such as credit default swaps and collateralised debt obligations. Whilst the use of these two tools was initially modest, their markets grew exponentially after the 2000 and played a crucial role in the recent subprime crisis (Lewis, 2010).

Since the 1980s, other countries began to adapt the practices the institutions and discourse of derivatives-based risk management. Some examples concerning organised markets can help illustrate the case. In 1978, the Amsterdam Stock Exchange Association established the European Options Exchange (NyseEuronext, 2012*a*). In 1979, the Sydney Futures Exchange listed financial futures (ASX, 2012). In 1982, the London International Financial Futures Exchange (LIFFE) began to trade futures and options on currencies and interest rates through an open outcry system

(NyseEuronext, 2012*b*). In 1985, Optionsmäklarna introduced options in Sweden (NasdaqOMX, 2012). In 1986, the French futures market *Marché à Terme International de France* (MATIF) traded contract on government bonds and introduced stock options soon after (NyseEuronext, 2012*c*). In 1988, the Swiss Options and Financial Futures Exchange was established (SIXGroup, 2012). In 1990, the Frankfurt Stock Exchange (now Deutsche Börse) created the Deutsche Terminbörse which traded futures contracts. The Frankfurt Stock Exchange had already introduced standardised stock options in 1983 (DBGroup, 2010).

2.4 Conclusions

Derivatives-like contracts existed long before US commodity exchanges initiated futures trading in the late nineteenth century. But, as this chapter has claimed, it is only at this moment in human history that derivatives were embedded in an institutional and discursive environment increasingly attuned to speculation as a mechanism of business-risk management. The creation of derivatives-based risk management articulated during the Gilded Age at a time when populists opposed futures trading as the worst facet of agricultural commercialisation. Once the aspirations of the populist movement were diluted into the pro-consumerist reforms of the Progressive Era, advocates of futures markets were free to enact speculation as a valid practice of risk management for corporate America.

During the 1960s and early 1970s, derivatives began to intersect American finance and its expansionary dynamics at home and abroad. In so doing, derivatives were rethought as instruments of risk management for financial investors. Derivatives approached financial markets at a time when the Nixon administration was open to the interests of financial actors. In fact, Washington was gradually realising that American finance represented a vehicle of US power in the world economy (Gowan, 1999; Konings, 2008*a*; Panitch and Gindin, 2008). In this context, CBOT and Merc successfully lobbied for the introduction of stock options and currency futures on organised exchanges (MacKenzie, 2006). The rising field of financial economics helped exchange officials by providing powerful intellectual support. Their theories isolated risk and price volatility as fundamental to every investment decision (Wigan, 2009).

Derivatives trading on financial assets grew considerably and became essential

for banks and institutional investors. However, this growth was hindered by regulatory uncertainties and a difficult economic scenario afflicting the US economy during the 1970s. Once the 1979 monetarist turn of the FED initiated the stabilisation of the domestic economy, American financial power consolidated in its global reach. Accordingly, after the 1981 Shad-Johnson Accords, derivatives markets expanded in size and innovation as demonstrated by the market for swaps, asset-backed securities and index derivatives. The US establishment recognised derivatives as important instruments of market efficiency. The 1987 stock market crash hardly affected this view about derivatives which were instead embedded in a pro-market regulatory regime. In the meantime, other countries began to adopt the institutions and discourses of derivatives-based risk management.

How and why did the Italian society embrace the institutions and discourses of derivatives-based risk management? Why and to what extent do derivatives in Italy reveal distinct features? In the next two chapters, this thesis leaves the United States to address the specificities of the Italian case.

Chapter 3

Modernising Italian capitalism: a historical account

This chapter begins to explore the dynamics of agential power, institutional and discursive construction through which modern derivatives were adapted in Italy. It shows that the historical evolution of Italian capitalism was characterised by complex equilibria between private business oligarchies and a vast public enterprise (Segreto, 1998). This private-public liaison secured ownership in the hands of the state and the oligarchs, reaching its most collusive essence during the 1980s. It is at this historical juncture that a pro-market technocratic elite – based primarily at the Bank of Italy and the Ministry of Treasury – advanced the idea of modernising the Italian political economy by disciplining public finances, privatising the state-owned sector and, few years later, modernising the financial system (Dyson and Featherstone, 1996; McCann, 2000; Deeg, 2005*b*). In so doing, these actors aimed at limiting those mechanisms which guaranteed the reproduction of conservative power structures. Whilst the process of European integration applied strong pressures in favour of market-oriented reforms, technocrats exploited these tendencies to impose an external constraint on the country's status quo (Dyson and Featherstone, 1996). By the time Italy adhered to the process of European monetary integration in 1992, the stage was ready for neoliberal reforms to be implemented systematically under the auspices of Europe (Sbragia, 2001). The significance of derivatives-based risk management emerged in Italy under such circumstances. The present chapter is divided into three main sections.

The first section reconstructs the origins of the highly concentrated structure of ownership and control in Italy from the late-nineteenth century industrialisation to the 1950s. Until the crisis of 1929, two universal banks, Banca Commerciale Italiana (COMIT) and Credito Italiano (CREDIT), weaved cross-shareholding alliances amongst national oligarchies. But, once these banks entered into a deep crisis of liquidity during the summer of the 1930, the Fascist dictatorship intervened to dismantle the system of universal banking. The state assumed control of COMIT and CREDIT together with the companies that the two universal banks had previously controlled. Furthermore, a system of semi-independent public institutes was put in charge of allocating long-term industrial credit, marginalising the stock market as a source of business investment and control. In so doing, the state became a new powerful actor in the Italian economy, one that nonetheless accommodated the interest of national private oligarchies. In this context, the financial holding Bastogi became the meeting place where to manage the equilibria between public and private ownership (Segreto, 1998).

At the end of World War II, the major political forces opted for a solution of continuity for what concerned the system of public enterprise and credit allocation. At the same time, the stock-market reform fell into oblivion and equity finance never became central to the functioning of the domestic economy. Hence, whilst public holdings controlled most part of the public industry and financial apparatus, oligarchs dominated instead private companies. In a word, the ownership benefits of Italian capitalism were limited to few powerful actors (Amatori and Brioschi, 2001; Barca, 2001). Bastogi worked well in calibrating this public-private liaison during the 1950s, but the financial holding was unable to counteract the dramatic expansion of the state-owned sector (Piluso, 1992). This phenomenon was the result of a specific political programme: Christian Democrats aimed at using state intervention to develop modern welfare institutions and to form a broad middle class upholding their power as the main ruling elite. Thus, the system of public industry and finance grew considerably. Over the course of the next three decades, it gradually turned into an instrument for Christian Democrats – and successively also for Socialist politicians – to guarantee their power position on the basis of patronage relations with public managers and society at large (Barca, 2001; Bianchi, 1987). Hence, whilst Bastogi declined, the merchant bank Mediobanca gradually gained a central posi-

tion in the defensive ownership strategies of private capitalism vis-à-vis the state. The 1962 nationalisation of the electrical energy sector marked the moment in which the interaction between public and private actors assumed more conflictual traits (Segreto, 1998).

The second section looks at the consolidation and development of the Mediobanca regime from the 1960s to the late 1980s. Mediobanca was established in 1946 with the capital of the former universal banks – and now under state control – COMIT, CREDIT and Banco di Roma. However, the merchant bank gained margins of autonomy by opening to private shareholders. Due to such a peculiar public-private nature of its shareholding syndicate, Mediobanca mediated the conflictual dynamics between the oligarchies and the expanding state-owned enterprise. It became the financial engineer for large private companies by providing funding strategies which guaranteed at the same time the oligarchic structures of ownership and control (Battilossi, 1991; Segreto, 2008).

During the 1980s, the concentrated traits of the Italian political economy assumed new complexities. On the one hand, the system of public ownership underwent a phase of restructuring and downsizing against the resistance of leading politicians, particularly the Socialists. In these years, political actors exploited state institutions and public expenditure for purposes of mass consensus (Bianchi, 1987; Ginsborg, 2001; Pasquino, 2000). On the other hand, major private corporations turned to equity finance. But, in spite of opening up to minority shareholders, Mediobanca made sure that national oligarchies kept their ownership ties intact through the use of pyramidal schemes, dual-class shares, cross-shareholdings and interlocking directorates (Aleotti, 1990; Amatori and Colli, 2001). In the same years, the merchant bank launched also a controversial plan for its own privatisation with the objective of increasing the weight of private capital in the syndicate. In so doing, Mediobanca aimed at decreasing political pressures on its activities (Segreto, 2008). However, by the late 1980s, new forces were already in motion that were about to transform the traditional power structure in Italy.

In fact, section three shows that neoliberal-minded ideas emerged within state institutions since the mid-1970s (Ciocca, 2005). Pro-market technocrats at the Bank of Italy and the Treasury put forward a critique of Italian capitalism that fundamentally clashed with conservative interests both in the public and private capital-

ist sphere. Over the course of the 1980s, technocrats gradually gained influence in a political-economic scenario the practices of which had reached the highest level of collusion and corruption (Ginsborg, 2001). Under the auspices of European integration, these actors exalted the benefits of reducing public debt, privatising the state-owned sector and modernising the domestic financial system (Dyson and Featherstone, 1996; McCann, 2000; Deeg, 2005*b*). In so doing, they aimed at hybridising domestic institutions and discourses in the attempt to shape the nature of power struggle to their advantage. By securing control over the decision-making process which led to the Maastricht Treaty in February 1992, technocrats connected Italy to the market-oriented dynamics of Europe (Dyson and Featherstone, 1996). Hence, from this moment onwards, reforms started to be implemented in a systematic fashion. Derivatives-based risk management played a fundamental role in these strategies (see chapter four).

3.1 The Italian case, 1861-1950

In the early 1930s, Adolf Berle and Gardiner Means (1968, 8) famously described the most crucial development of modern capitalism as “the dissolution of the old atom of ownership into its component parts, control and beneficial ownership.” In other words, Berle and Means argued that the consolidation of the joint-stock company implied a separation of corporate ownership and control such that a myriad of dispersed owners – the shareholders – emerged. Whilst diversifying their investment portfolios across several firms listed on the stock exchange, these shareholders exerted almost no control over the managers who effectively ran day-to-day operations. The condition was such that the latter were potentially able to form a ‘technostructure’ through which they could consolidate their power over other social groups (Galbraith, 2007). The research by Berle and Means became very influential and their ideas about the consolidation of managerial capitalism were unchallenged for a long time.⁹⁶ Many studies focused instead on the various practices that could solve the so-called ‘principal-agent’ problem such as independent boards of directors, fiduciary duties and the market for corporate control (Jensen and Meckling, 1976; Grossman and Hart, 1988). These innovations were supposed to make man-

⁹⁶For two critiques, see Dobb (1964) and Zeitlin (1974).

agers accountable to shareholders. What is more, the argument of Berle and Means was assumed to be valid also for industrial economies other than the United States (Becht and Mayer, 2001, 1), where the modern corporation assumed its most emblematic character (Roy, 1997).

In recent years, however, several scholars have emphasised the existence of different degrees of separation between ownership and control across the world (Clarke, 2007, 85). For instance, Julian Franks and Colin Mayer (1997) conceptualised the phenomena in question through the lenses of an ‘insider-outsider’ model. The US and UK are ‘outside’ cases where the separation between ownership and control is wide enough for shareholders to be primarily concerned with making managers accountable. Continental Europe is instead fairly different and sits at the other side of the spectrum. To begin with, ‘insider’ countries such as Germany, France or Italy present few listed companies on the stock market. Second, for what concerns the listed ones, share ownership is concentrated in the hands of three groups, namely: founding families, other non-financial companies (cross-shareholding) and the state.

Hence, similarly to other European experiences, the logic of Italian capitalism is characterised by a relatively limited separation of ownership and control. In this sense, the Italian story is not one in which dispersed shareholders develop mechanisms to make strong managers accountable (Roe, 1994). In Italy, the problem concerns instead the presence of strong blockholders (oligarchs, state) influencing the activities of weak managers against the interests of unprotected minority shareholders (Melis, 2000, 354). It is the imperative to hold such high degrees of ownership concentration in the hands of few actors – whilst at the same time maintaining open channels for external funding and corporate growth – that encouraged blockholders to gather around several gravitational centres of Italian capitalism (Segreto, 1997, 649). Reconstructing the evolution of these artifices is crucial to comprehend the conservative power structures that neoliberal reformists aimed at changing in the early 1990s, allowing derivatives-based risk management to emerge in Italy as an essential component of their strategies.

This section looks first at the early years of industrialisation and the importance of COMIT and CREDIT in weaving cross-shareholding alliances. Then, it focuses on the emergence of the state as a fundamental economic actor as well as on the role of the financial holding Bastogi in balancing the ownership equilibria between

private capitalism and the public enterprise from the 1929 crisis until the late 1950s.

3.1.1 The years of COMIT and CREDIT

The early Italian industrialisation was forged by a close relationship between foreign capital and the state in the late nineteenth century. It could not have been differently in a newly unified nation (1861) characterized by three ‘organic weaknesses’, namely: scarce natural resources, inadequate capital due to a limited phase of primitive accumulation and a highly fragmented domestic market – itself a result of the previous division in several small independent states (Grifone, 1971, 5). Hence, industrial capitalism emerged in Italy by depending on foreign-influenced banks and the role of political elites in their difficult project of nation building.

Concrete efforts to create a modern industrial base were not put in place until the government of the so-called *sinistra storica* (historical left) got to power in 1876 and implemented protectionist measures which reached the apex in 1887. Protectionism encouraged economies of scales in textile production and technological improvement in the steel industry and chemicals (Aleotti, 1990, 35-37). However, these developments were hindered by the fragility of the Italian banking system which was overexposed to commercial and industrial activities as well as a real estate boom in cities like Rome, Turin and Naples. This led to the the 1893-94 banking crisis and the collapse of the two main banks Credito Mobiliare and Banca Generale (Zamagni, 1993, 142-144).

In spite of the dramatic disarray, this crisis marked a turning point in Italian history. Political and business elites reached a certain degree of national coherence and undertook an important process of institutional restructuring. First, the Bank of Italy was established in 1893 as a sort of *primus inter pares* amongst the other two banks of issue, Banco di Napoli and Banco di Sicilia.⁹⁷ This represented a first step in the creation of a more homogeneous banking and monetary structure which until then had suffered from traditional localisms. Second, German-Austrian capital arrived in Italy with the creation of two universal banks, COMIT and CREDIT (Segreto, 2008, 787-789).⁹⁸

⁹⁷About the origins and evolution of Bank of Italy, see Cotula, De Cecco and Toniolo (2003).

⁹⁸COMIT was created in 1894 by German, Austrian and Swiss capital. CREDIT was instead established in 1895 by Genoese financiers with the help of other Italian, German and Swiss capital. It is important to note that by 1901-02, the participation of German capital both in COMIT and

During the so-called ‘Giolitti era’ (1897-1913),⁹⁹ the two universal banks financed activities of both the first and second technological revolutions (Gerschenkron, 1966; Confalonieri, 1974; Fohlin, 1998).¹⁰⁰ COMIT and CREDIT were behind strategic sectors such as electricity and hydroelectric power (Edison, SADE), steel (Terni, Falk), chemicals (Montecatini), vehicles (FIAT) and locomotives (Breda) (Amatori and Colli, 2001, 4). These banks also offered managerial advice to companies through the presence of so-called *fiduciari* (Pino, 1991). Last but not least, COMIT and CREDIT favoured the formation of joint-stock companies and stimulated the growth of the stock market. Established in the most important cities by a Napoleonic Act during the years between 1802 and 1808, the national system of stock exchanges – commonly known as *borsa* – experienced a remarkably speculative expansion at the turn of the twentieth century, a phase which ended with the 1907 crisis.¹⁰¹ These critical events pushed the authorities to implement a reform of the stock market in 1913. But, the latter did not entail any transparency rules for corporate governance or regulation on insider trading (Aleotti, 1990, 63-64, 73-76).

The problems concerning stock-market activities reflected an anomaly of Italian universal banking. In Germany, banks were well integrated with stock-market operations (Fohlin, 2007). In Italy, on the contrary, banks fell short of developing their investment-banking operations, namely: raising new equity or debt capital for companies on the market (underwriting); as well as making secondary markets for these securities (brokerage/dealing). This occurred for two reasons. First, Italian industrialists resisted the dispersed nature of public ownership (Segreto, 2008, 792). They preferred instead to secure control over their companies, whilst nevertheless leaving open the opportunities for external funding by the banks. Second, in the absence of an effective stock-market regulation, government bonds attracted the majority of savings. In this context, universal banks could only rely on their de-

CREDIT was drastically reduced in favour of Italian, French and Belgian shareholders (Zamagni, 1993, 144-145).

⁹⁹Giovanni Giolitti was the politician who inaugurated a period of social reforms in Italy. See Forsyth (1993).

¹⁰⁰Besides COMIT and CREDIT, Banco di Roma (1880) and Banca Italiana di Sconto (BIS, 1914; formerly known as Società Bancaria Italiana, 1904) were the other two universal banks. However, these institutes had no substantial support from foreign capital and played a minor role in the country’s industrial development (Zamagni, 1993, 146), except for the case of BIS and its mismanaged expansion during World War I up until its bankruptcy in 1921 (Sraffa, 1922).

¹⁰¹About the origins and evolution of the Italian *borsa*, see Aleotti (1990), Baia Curioni (1995) and also BorsaItaliana (2012). About the 1907 crisis, see Bonelli (1971).

posits and on access to funds from volatile international capital markets (De Cecco and Ferri, 1996, 27-28). As a result, the development of Italian business came to be characterised by an oligarchic structure of ownership and control. Accordingly, in case of liquidity crises by the banks, state intervention – as exemplified by the several bailouts in 1894, 1921, and the decisive one in 1931 (Tattara and Toniolo, 1976, 134) – provided a safe solution to socialise losses whilst keeping the power of family oligarchies intact.

In this overall rationale of Italian capitalism in its cradle, the hegemony of COMIT and CREDIT to weave the alliances of private business was unquestioned until World War I. The banks succeeded in forming a network of cross-shareholders where the two institutes represented the centre of gravity (Segreto, 1997, 650). However, this situation changed after the conflict when, mostly due to warfare commissions, several industrial groups had grown to the point of unravelling the balance of forces between banks and the industry. Large family-owned companies such as Ansaldo and FIAT unsuccessfully attempted to take over the banks in search for new capital to finance overly bloated investments and post-war reconversion (Zamagni, 1993, 233). Whilst such events agitated the business world, the country experienced an economic crisis which intensified labour strikes and led to the occupation of factories. In this scenario, industrialists lost faith in the Giolitti government and its ability to solve the situation. The rupture between liberal-reformists and industrialists played an important role in paving the way for the emergence of Fascism (Eley, 1983).

The falling apart of the old bank-industry synergies forced CREDIT and COMIT to concentrate their ownership structures in two holdings: COMOFIN and COFINA. Banks exploited regulatory gaps concerning cross-shareholdings and, in so doing, succeeded in controlling COMOFIN and COFINA together with a group of allied bankers and industrialists (Battilossi, 2009, 111-112). In this scenario, banks experienced a period of expansion during the first half of the 1920s. They upheld the export-led economic boom favoured by the displacement of German exports and the ability of the Fascist regime to contain monetary wages (Filosa, Rey and Sitzia, 1976, 55-57). Between 1921 and 1925, total bank lending to the private sector increased at an average annual rate of 23.7%. Moreover, both demand and time deposits grew at an annual average rate that was 2.5 times the growth in national income. Net profits

for many of the joint-stock banks went up to 10% of their own funds. Again, this buoyancy had a significant impact also on the stock market the index of which grew by 160% between 1922 and 1925. However, banks began to experience difficulties as of 1925. In that year, the stock-market index started to decline and banks had problems in liquidating their shares (Ciocca and Toniolo, 1984, 120-122). These difficulties further increased when the dictatorship undertook the deflationary policies of ‘quota 90’ in 1926 (Cohen, 1972; Martinez Oliva, 2006). Finally, banks entered into a deep liquidity crisis once the repercussions of the 1929 crisis hit the Italian economy (Toniolo, 1978). In this situation, the opportunity for a radical transformation of the country’s financial system and economic structure emerged. This enhanced the role of the state and, for this reason, new equilibrating mechanisms in the structure of ownership and control were necessary. The next subsection looks at the emergence and consolidation of Bastogi as the centre of ownership gravity for Italian capitalism.

3.1.2 Bastogi: balancing public and private equilibria

When the repercussions of the 1929 crisis reached the Italian economy in the summer of 1930, banks ran into a deep liquidity crisis. Due to the distinct bank-industry concentration, COMIT and CREDIT were first of all substantially exposed to long-term industrial projects for those sectors most heavily hit by the slowdown. Second, their assets were illiquid, as mainly made of industrial equities the share prices of which were declining dramatically. Third, bank deposits were growing at a lower rate compared to previous periods. Finally, these banks were borrowing abroad and the lines of credit were interrupted in the 1930 (Ciocca and Toniolo, 1984, 130). In this situation, the Fascist dictatorship opted for a radical solution which replaced universal banking with a system of public credit.

The opportunity for a radical transformation of the country’s financial system was put forward by the managerial milieu which had flourished under the leadership of the Socialist reformist Francesco Saverio Nitti since the crisis of 1907. The ideas of his protégé Alberto Beneduce – together with those of other managers such as Bonaldo Stringher and Donato Menichella – concerned the creation of so-called special credit institutes (SCIs) as entities of state-led development. Separated from the ordinary public administration, these public institutes were to be directed by quasi-independent technocrats. At that time, the main SCIs were Consorzio di Cred-

ito per le Opere Pubbliche (CREDIOP, 1919), Istituto di Credito per le Imprese di Pubblica Utilità (ICIPU, 1924), Istituto per il Credito Navale (1928) and, after the crisis, the well-known Istituto Mobiliare Italiano (IMI, 1934). But, as it is shown later, their number and importance increased dramatically after World War II. SCIs were financed by Cassa Depositi e Prestiti (Cassa DP) as well as other public agencies such as the Istituto Nazionale Assicurazioni (INA) and Cassa Nazionale per le Assicurazioni Sociali (successively known as Istituto Nazionale Previdenza Sociale, Inps). During the 1920s, these institutes were involved in financing railroads, electricity and land reclamation (Barca, 2001; Cianci, 1977; De Cecco, 2001; Mortara, 1984).

Under the advice of this state-managerial apparatus, the Fascist dictatorship intervened in 1931 to solve the liquidity crisis through two agreements with CREDIT and COMIT. Banks had to sell their industrial portfolios to two holding companies (Sofindit and SFI), which were both controlled by the Ministry of Finance and the Bank of Italy.¹⁰² CREDIT and COMIT – as well as Banco di Roma (the country's third universal bank) – were officially prohibited to allocate long-term industrial credit and were transformed into commercial banks. However, once these agreements were signed, two problems still remained. On the one hand, the Bank of Italy held a large quantity of illiquid assets. On the other hand, fundamental sectors of the Italian industrial apparatus were cut off from their lines of credit overnight. At this point, the solution came in the form of a further interventionist strategy which led to the creation of Istituto per la Ricostruzione Industriale (IRI) in the early 1933. This government-owned holding first received from Sofindit and SFI all the industrial portfolios, and then issued long-term bonds with a fixed interest and equivalent to Treasury bonds (Ciocca and Toniolo, 1984, 132-133).

In so doing, the state assumed control of the companies previously financed by the main universal banks, namely a large portion of the national industry: over 21% of all the equity capital of Italian joint-stock companies; 100% of shipbuilding and 80% of maritime shipping; 80% of locomotive manufacturing; 40% of the civilian steel industry; 30% of electricity production; respectively 20% and 13% of the rayon and cotton outputs. Moreover, IRI owned several mechanical engineering firms and real estate holdings. It controlled the largest banks (former universal banks) and

¹⁰²In the meantime, Bank of Italy had become the only note-issuing institute since 1926 (Zamagni, 1993, 295-297).

a substantial part of the telephone service (Barca and Trento, 1997, 547). Initially conceived as a temporary solution, IRI was eventually transformed into a permanent entity in May 1937. This was due to the dictatorship's intention to use IRI as a structure for industrial policy as well the inability to attract enough private capital to re-privatise the firms owned by the state holding (Cianci, 1977).

It is important to note that the so-called 'IRI formula' implied that IRI was a public holding by law and, for this reason, it followed objectives of public interest under political guidance. However, and this was a peculiar feature of the Italian system of public enterprise, IRI controlled joint-stock companies that were open to private shareholders and market-competition rules. In other words, the system was based on a very delicate balance between political advice and managerial autonomy, an aspect which reflected the philosophy of the Nittian technocrats. As it is shown later, political parties undermined this balance of power from the late 1950s onwards, when they began to develop mutual relations of financial support and political tutelage with public managers (Bianchi, 1987, 269, 277).

Thus, the state became the most important actor in the ownership structure of Italian capitalism. It is in this context that Bastogi assumed the fundamental role of a meeting place where to cultivate the equilibria between private and public ownership. The Società per le Strade Ferrate Meridionali – commonly known as Bastogi by the name of its founder Pietro Bastogi – had made a profitable use of the generous compensations obtained by the state after the 1905 railway nationalisation. After being involved in the Southern railway development, Bastogi transformed itself into a financial holding.¹⁰³ In the 1920s, under the influence of its major shareholder COMIT, Bastogi directed funds primarily towards the electrical companies. In so doing, it became crucial to the control of this strategic sector. After the bailout of the universal banks and their dismantling in 1931, IRI returned Bastogi to the former shareholders. This move was crucial in granting the financial holding the role of coordinator in the cross-ownership equilibria of Italian capitalism as a whole. In particular, Bastogi's syndicate was formed by: the traditional oligarchies such as Agnelli, Pirelli, Orlando; the state holding IRI of which president Beneduce had already become the chairman of Bastogi since 1926; finally, the Istituto per le Opere Religiose (IOR or, more commonly, the Vatican bank) also participated in the syn-

¹⁰³About the history of Bastogi, see Piluso (1991, 1992).

dicate (Segreto, 1997, 652). In sum, Bastogi represented the first episode of what authoritative journalists later labelled as the *salotto buono* of Italian capitalism – referring to the case of Mediobanca (see next section). Up to the present time, this term indicated an exclusive clutch of business and political echelons whose purpose was to manage tacitly the existing ownership equilibria through shareholding alliances (Economist, 2010).

The two dimensions of Italian capitalism – public and private – co-existed through a division of roles in different industries and services. In this regard, the state accommodated the interests of existing private oligarchies. However, the ‘public hand’ obtained full control over the organisation of finance, a power that was sanctioned by the 1936 law on banking.¹⁰⁴ Here, two intertwined aspects were important. First, the Bank of Italy was endowed with a wider role in the management of monetary policy. Second, once universal banks were transformed into ordinary banks, the latter were also prohibited from holding equities. In so doing, the allocation of credit was segmented into two dimensions, long-term special credit and short-term ordinary credit. Banks were allowed to provide ordinary credit, whilst SCIs were put in charge of allocating medium and long-term funds (Ciocca and Toniolo, 1984, 134). As it is shown later, the expansion of SCIs marginalised the stock market as a source of business investment and corporate control, at least until the 1980s.

3.1.3 From Bastogi to Mediobanca

To recapitulate, this section has thus far explored the formation of those early practices which the political and business establishment adopted in order to limit the separation of ownership and control in Italian capitalism. After the decline of COMIT and CREDIT as a result of the 1929 crisis, the financial holding Bastogi assumed particular significance due to its role as a centre of gravity between the interests of private oligarchs and a new powerful actor: the public enterprise. The two dimensions demonstrated a certain degree of peaceful coexistence, although the state gained full control of finance. This final subsection examines how Bastogi positioned itself within the strategies of ownership and control during the early

¹⁰⁴My translation of what the Italian literature often defines as *legge bancaria 1936*. It refers to the legislative process that began with the royal decree no. 375, March 12, 1936 and the royal decree no. 1400, July 17, 1937. These two decrees were then converted into law no. 141, March 7, 1938 and law no. 636, April 7, 1938. See Galanti (2008, 55).

post-war years. Furthermore, the analysis looks at the inadequacy of Bastogi in equilibrating the dramatic expansion of the public enterprise after the nationalisation of the electrical industry in 1962. This episode represented a turning point that determined the transition from Bastogi to Mediobanca as the new gravitational pole for the ownership structures of Italian capitalism.

The end of World War II marked the beginning of an intense process of modernisation that transformed Italy into a manufacture-exporting economy. In 1947, under the auspices of the Truman doctrine, the party Christian Democracy (Democrazia Cristiana, DC) secured the domestic political arena vis-à-vis the Communist Party (Partito Comunista Italiano, PCI). DC formed a dominant bloc together with liberal technocrats, whose economic ideas were instrumental in guaranteeing wage moderation and establishing an export-led strategy within the Western geopolitical context. The country's export specialisation shifted towards modern industries (vehicles, chemicals, metallurgy, mechanical engineering) and the low-wage regime made possible to gain competitive quotas for such products. This political-economic design generated sustained economic growth, price stability and an external-balance equilibrium over the period 1952-1963. However, it produced also profound distortions such as the 'dualistic' structure of the economy, mass emigration from the Southern regions, uncontrolled urbanisation and a dramatic lack of social services. These problems eventually erupted in a scenario of intense unrest which reached its peak during the 1970s (Allen and Stevenson, 1974; De Cecco, 1979; Graziani, 1979; Kindleberger, 1967).

The public-private structure – as established under the Fascist dictatorship – was part and parcel of these post-war developments. In fact, during the years of reconstruction (1945-1950), DC left the system of state-owned enterprise and public credit mainly unchanged. The issue of continuity and change with the economic institutions of Fascism was debated at the 1946 constituent assembly. But, in the end, political forces decided in favour of the strengthening of the state-owned sector as a vehicle of employment and welfare. The IRI formula was re-confirmed as an important balance between autonomous public managers and political parties (Bianchi, 1987, 275-276). What is more, the constituent assembly considered the adoption of a new stock-market regulation (Morelli and Pace, 1984; Bagella, 2006, 55-61). But, the debate ended up focusing on mere incentives in the form of tax reduction on

Type	1936	1950	1960	1970	1975
Industrial credit	6	17	30	32	32
Mortgage credit	12	13	15	21	21
Public infrastructure	-	1	9	13	19
Agricultural credit	10	10	13	13	13
Total	28	41	67	79	85

Table 3.1: Evolution of SCIs, number of institutes at the end of each year, 1936-1975.
Source: adapted from Pontolillo (1978, 288).

equity holding. There was instead no concrete reforms concerning the commercial code, antitrust law and market transparency. Eventually, in spite of a short-lived growth of the stock market in the early 1950s, the possibility to consolidate its importance in the domestic economy soon vanished under the influence of an adverse political and cultural climate (Barbiellini Amidei and Impenna, 1999).

In a context where the predominance of loans over equity was never concretely questioned, the legal separation between ordinary and industrial credit legitimised the expansion of SCIs even outside the system of public ownership. To illustrate this last aspect, table 3.1 shows the evolution of these institutes in numerical terms and by category. In 1936, there were 28 institutes mainly involved in mortgage credit and agriculture. The number jumped to 67 in 1960, and 85 in the mid-1970s. As it is clear, the major developments occurred in the allocation of both industrial and mortgage credits, in line with the transformation of the country's economic structure. Throughout the post-war decades, SCIs consolidated into a threefold structure (Zamagni, 2008; Piluso, 1999). First, the institutes created by Beneduce before the 1936 law on banking (CREDIOP, ICIPU, and IMI) were related to government policies. Accordingly, public ownership (Treasury, Cassa DP, social security institutes) prevailed. Second, new institutes such as Mediobanca, Efibanca, Centrobanca and Interbanca were involved in allocating credit to medium and large-scale companies. Third, the regional network of Mediocredito, as well as those institutes specific to the Southern development – such as Istituto per lo Sviluppo Economico dell'Italia Meridionale (ISVEIMER), Istituto Regionale per il Finanziamento alle Industrie in Sicilia (IRFIS), and Credito Industriale Sardo (CIS) – were close to the necessities of small and medium-sized enterprises (SMEs).¹⁰⁵

¹⁰⁵The vicissitudes around the constitution of Mediobanca are described by Asso and Raitano

The continuity in the system of public enterprise and finance was accordingly visible in the highly concentrated structure of ownership and control in private companies. As Fabrizio Barca (2001, 43-45) pointed out, the decisions to legitimise the *status quo ante* concerning the ownership arrangements of private business was due to three interrelated reasons. First, the regime of low wages – together with its practically unregulated labour market and the vast reserve of unemployed workforce (Cella, 1989; Reyneri, 1989) – diffused the perception that margins of profit were going to be substantial. This reduced the necessity to turn to external investors, as investments were in large part self-financed. Second, many believed that Italian savers were traditionally disinterested in equity wealth, often considered obscure and fraught with dangers. In the light of this public scepticism, it was difficult to transform the stock market into a transparent institution of industrial credit and monitoring. Finally, the Nittian managers – who, in the meantime, were cleared of their previous loyalty to the dictatorship – firmly opposed the idea of leaving entrepreneurs exposed to the vagaries of the stock market.

Thus, in the early 1950s, Italian capitalism appeared as one of ‘limited suffrage’ (Amatori and Brioschi, 2001, 119). Its traits of ‘mixed economy’ revealed a peculiar liaison between private and public in which both dimensions were similarly insulated from the dispersion of ownership and transparent control structures. Whilst the system of public enterprise was controlled by the state, each private company was in the hands of one family – except for Montecatini which was nonetheless controlled by few blockholders. The core of private business was the electricity sector and its leading company Edison. Another important actor in the sector was SADE, the interests of which expanded in textiles, real estate, hotels and tourism. Two financial holding played a fundamental role in the electricity industry: the already mentioned Bastogi and La Centrale – which was controlled by the Pirelli and Orlando families. Not far from the centre of private capitalism were three other companies: FIAT, Montecatini and Pirelli. The Turin-based car manufacturer was controlled by the Agnelli family and held the leading position in the sector. Montecatini was instead involved in the chemical industry. Initially founded as a mining company in 1866,

(1999) and one of the rare speeches given by Cuccia (1986) in memory of Mattioli. About Centrobanca, see again Asso and Raitano (1999). About the events which led to the transformation of EFI into Efibanca, see Bagella (1999). About the system of Mediocredito, see Peluffo (1997). About ISVEIMER, see Croce (1999).

it was transformed into a chemical empire during the interwar period. Finally, for what concerns Pirelli, its core activities were the production of tyres and cables for telecommunications and energy (Amatori and Brioschi, 2001, 119-120).

The architectures of ownership in the private industry were so complex that they secured control even when the ownership quotas of blockholders decreased as a result of business expansion. Two mechanisms were indispensable for such condition to be achieved. The first one was the pyramidal group, in which two or more companies were legally separated but controlled by a holding through ownership chains. For instance, at the top of the pyramid sat the family-owned holding, whilst all the other companies had a mere subsidiary role. Of course, the voting rights of minority shareholders were dispersed over a large number of these subsidiary firms. The blockholders' shares were instead concentrated in the holding at the top of the pyramid. Second, besides these pyramidal constructions, cross-shareholding alliances were cultivated to further secure a narrow separation of ownership and control. Such coalitions linked blockholders into structures of mutual dependence. In addition to these two mechanisms, several other artifices were adopted such as: including insurance companies as part of the pyramidal group in order to inject liquidity whenever it was needed; proxy votes with no obligations by the proxies to the principals; or the possibility for the management to refuse new shareholders as a protective measure against takeovers. Of course, the inefficient stock exchange and the absence of a transparent corporate governance regime completely sealed the power of blockholders over minority shareholders (Barca, 2001, 44-46).

The Bastogi mode of control worked well in calibrating such private-public equilibria during the 1950s, but several difficulties became visible. First, IRI withdrew from the controlling syndicate in 1954, a role which was replaced by the Governor of the Central Bank Menichella as arbitrator of shareholding pool agreements. A block syndicate was formed in which Italcementi, IOR, and Assicurazioni Generali prevailed over the historical group formed by Edison, Montecatini, Pirelli, FIAT and Riunione Adriatica di Sicurtà (RAS). As a consequence, Bastogi came to represent the interests of one specific private group and gradually lost the legitimacy as the neutral arbiter of Italian capitalism (Segreto, 2008, 801). Second, and more importantly, the difficulties of Bastogi also stemmed from the inability to provide defensive strategies for private capital in the face of a dramatic expansion of the

public enterprise (Piluso, 1992, 386-391). This aspect merits some further clarification in order to understand the historical forces behind the decline of Bastogi and the emergence of Mediobanca.

In the mid-1950s, the balance of power within Christian Democracy shifted in favour of the social-Catholic faction. These actors began to elaborate a plan for the development of modern welfare institutions and the formation of a broad middle class in support of their elite power (Bianchi, 1987, 276). This plan implied a comprehensive rationalisation of the economy as well as a thorough reconsideration of state intervention. The latter was to be put under a more strict form of political control. In this regard, two dimensions were crucial. First, the system of public enterprise and SCIs such as IMI, ICIPU and CREDIOP were to be brought under the authority of political parties and away from the managers. Second, the rate of productivity had to replace the centrality of profit as an indicator of economic success (Barca, 2001, 84-87). These ideas soon attracted the attention of the Socialist Party (Partito Socialista Italiano, PSI), the programme of which converged with Christian Democrats on the experiment of economic planning. This project came into being when the first DC-PSI government was formed in 1963 (Ruffolo, 1973).

The growing influence of the social-Catholic faction within DC – and their gradual convergence with the Socialist platform – led to the establishment of the Ministry of State Shareholdings in 1956. This Ministry reorganised the system of state holdings that, besides IRI, now included also the following conglomerates: Ente Nazionale Idrocarburi (ENI), established in 1953 and involved in oil and gas production; the Ente Gestione Attività Minerarie (Egam), Ente Autonomo di Gestione per il Cinema (Eacg), and the Ente Autonomo di Gestione delle Aziende Termali (Eagat), which were all created in 1958 and respectively involved in mining, cinema, and thermal baths; finally, Ente per il Finanziamento dell'Industria Manifatturiera (Efim), founded in 1962 and involved in machinery, glass and aluminum industries (Toninelli, 2004, 59).¹⁰⁶ Furthermore, the Ministry of State Shareholdings advanced a far-reaching plan for the industrialisation of the Mezzogiorno (Graziani et al., 1973). State-owned companies were obliged to localise 60% of their new investments, as well as at least 40% of their total investments, in the Southern regions.¹⁰⁷ As a

¹⁰⁶About the system of state shareholding in Italy, see Amatori (2000).

¹⁰⁷Cf. law no. 634, July 29, 1957. Unless otherwise referenced, this and all the following Italian laws and decree laws (enacted in the period 1945-2012) were consulted through the institutional

result, industrial investments in the South reached a level of 25% of the national whole in the period 1958-1963. In the meantime, the network of Autostrade – the state-owned company for highways – expanded in proportion with the motorisation of Italian society. In a word, public investments substantially influenced the national economic cycle (Bruno, 1995).

However, it was the nationalisation of the electricity sector – with the creation of the Ente Nazionale Energia Elettrica (ENEL) in December 1962 – that represented the most important political-economic move of the DC-PSI alliance. Initially conceived by Nitti at the beginning of the century, the project became a central aim of the Socialists since 1955 (Scalfari et al., 1960). Intense negotiations began in 1962 and focused on the modalities of compensations, particularly whether these were to be given to the shareholders as the ultimate owners or the companies' oligarchs. Considering the intentions of decreasing the political influence of the *baroni elettrici*, the logical solution would have been to indemnify the shareholders. The latter was the position advanced by Socialists, the social-Catholic faction and the Communist Party. However, the Governor of the Bank of Italy Guido Carli – who replaced Menichella in 1960 – advocated the opposite solution. He argued in favour of giving companies' managers the possibility to open a new course for the Italian industry (Carli, 1993, 296). In fact, according to the Governor, the balance of power between public and private was such that it was necessary to be more attentive to the interests of private capital. In the end, this was the agreement reached. But, later on, this path came to be gravid of managerial incompetencies as the very same Carli (1976) admitted in a famous interview.

The establishment of ENEL considerably increased the weight of the state enterprise. Together with ENI, the entire energy sector was now brought under state control. In this context, DC put forward its idea of creating a modern middle-class nation through an intense process of industrial transformation. However, this ambitious project had a fundamental consequence: it subverted the core principles of the IRI formula. As Patrizio Bianchi (1987, 277, *my italic*) pointed out:

[...] the reinforcement of the public company system became the instrument of the establishment to demonstrate the centrality of the DC inside the Italian political system. But this reinforcement also became the way

to emphasise a new politics – business connection between politicians and public managers which upset the institutional balance of powers which had characterised the ‘TRI-formula’ [...] Public managers started to support political groups essentially within the DC, and these groups started to offer protection to public managers. The main result was to create a vicious circle for the mutual promotion of the interests of politicians and public managers. *The political struggle was accentuated by the aim of controlling public firms and, therefore, of providing political groups with the means of self-reproduction.*

From this moment onwards, the Italian political-economic scenario became marked by two intense forces – public and private capitalism – with their respective logics and points of friction. On the one hand, governing political parties were concerned with controlling and driving the expansion of public enterprise as a way to guarantee their ‘self-reproduction’. In so doing, the dynamics of so-called *partitocrazia* came into being, a condition in which the ruling parties, DC and PSI, eliminated any possibility for alternation in power and consolidated their clout over the state and society at large (Pasquino, 1995*b*). They politicised appointments in nearly every public institution – from banks to hospital, via schools and post offices – through widespread networks of patronage and factional loyalty (Ginsborg, 2001, 139-142).¹⁰⁸ On the other hand, private oligarchs necessitated of adequate solutions to protect their ownership structures against the expansion of the state-owned apparatus.

In this context, it was clear that Bastogi was unable to mediate the latest synergies between public and private. Hence, Mediobanca arose to the status of new gravitational centre for the management of ownership equilibria.

¹⁰⁸DC was a heterogeneous party – organised in different factions (or *correnti*) – with strong consensus amongst the petty bourgeoisie. This aspect opened up many possibilities to establish relations of patronage, that is the ability to control office appointments or the entitlement to any sort of privilege. In fact, the petty bourgeoisie – e.g. smallholders, shopkeepers, independent professionals, public white-collar employees, small entrepreneurs – is particularly dependent on forms of assistance such as subsidies, protective legislation and tax exemptions. Of course, besides the petty bourgeoisie, DC had also a large support base amongst blue-collar workers and other lower-class fractions, whose members (especially in the Southern regions) were granted disability pensions in spite of not being entitled to them. For what concerns PSI, this party aimed at becoming an inter-class entity like DC, especially once Bettino Craxi became the leader (1976). Since its electorate was less stable, PSI relied more than DC on using the state resources to attract consensus. It is well known how their methods of patronage were very ruthless. For instance, they demanded higher kickbacks and a wider Socialist representation in key positions of the state-owned sector. See Amyot (2004, 96-105).

3.2 Counteracting the expansion of the public enterprise

Thus far, this chapter has examined the origins and evolution of the highly concentrated structure of ownership and control in Italian capitalism. It has first looked at the period from the late nineteenth century until the emergence of the public enterprise in the 1930s. During these decades, universal banks led the process of early industrialisation and weaved cross-shareholding alliances. However, these banks experienced a dramatic liquidity crisis in 1930. At this point, the Fascist dictatorship intervened by dismantling the system of universal banking, by gaining control of the companies which the banks had previously owned and, finally, by positioning SCIs in charge of allocating long-term credit. In this context, as the state emerged as a new powerful economic actor, the financial holding Bastogi assumed the role of arbiter in the coordination of the public-private equilibria. Yet, the dramatic expansion of the state-owned sector overturned the balance of power in favour of state capitalism from the late 1950s onwards. As a result, Bastogi became inadequate as the guarantor of the political-economic equilibria. For this reason, the present section looks at the emergence of Mediobanca and how this actor evolved to become the new *salotto buono* of Italian capitalism. Mediobanca was unique in serving the necessities of private corporate echelons whilst mediating their interaction with the expanding public enterprise. The first part of the section examines the period from the creation of Mediobanca in 1946 to the late 1970s. The second part focuses the attention on the strategies of Mediobanca during the 1980s, a period of stock-market boom as well as decline of the public enterprise.

3.2.1 Mediobanca in the 1960s and 1970s

If IMI, CREDIOP and ICIPU were the largest special credit institutes in terms of volume of credit allocated (table 3.2), Mediobanca was instead the custodian of ownership structures for the big private business (Lombardo and Zamagni, 2009). Compared to IMI, which was subject to public law, Mediobanca was a joint-stock company listed on the Milan stock exchange since 1956. Up until the reforms of the 1990s, the institute was the only effective investment bank in the Italian scenario (De Cecco and Ferri, 1996). Raffaele Mattioli and Enrico Cuccia – respectively,

Institute	% credit
IMI	28.6
CREDIOP	16.8
ICIPU	12.8
Mediobanca	10.6
Mediocrediti	8.3
ISVEIMER	5.3
Efibanca	4.1
Interbanca	3.4
Sezz. public banks	3.2
CIS	2.8
Centrobanca	1.4
IRFIS	1.6
others	1.9
Total	100.0

Table 3.2: Percentage volume of credit allocated by SCIs involved in industrial financing, 1975.

Source: adapted from Bisoni (1979, 15).

president of COMIT and former manager of IRI and Bank of Italy – established Mediobanca in September 1946. Mattioli and Cuccia aimed at creating a SCI that could act as an investment bank for large private companies in spite of being controlled by the state. The Bank of Italy and IMI were initially opposed to the creation of Mediobanca. But, Mattioli and Cuccia eventually prevailed with the financial support of two other partners, CREDIT and Banco di Roma (Asso and Raitano, 1999; Cuccia, 1986). In other words, Mediobanca’s capital came from the very same former universal banks which, after the post-1929 bailout, were now under control of the state holding IRI as the majority shareholder.

During its first years, Mediobanca provided financial support to big companies mainly in the form of debt securities. The institute used the branches of COMIT, CREDIT and Banco di Roma in order to undertake its activities. In this period, although with increasing difficulties, Bastogi was still the mediating centre of national capitalism. However, as of its initial public offering (IPO) in 1956, Mediobanca moved away from the influence of the state-controlled banks by opening up to private shareholders (Segreto, 2008, 799-800, 802). In detail, the institute established a corporate governance design in 1958 – which was not officially revealed to IRI (the

majority shareholder of state-owned banks) until 1983 – that guaranteed a parity condition between the representatives of public banks and those of private capital. This occurred in spite of the fact that the former held three times more assets than the latter (Battilossi, 1991, 646-647). The important aspect of this apparently contradictory governance is that it allowed Mediobanca to balance the two dimensions of public and private capitalism, guaranteeing certain margins of autonomy from politics.

In the mid-1960s, the scenario was finally ready for Mediobanca to play a major role in Italian business. As shown before, the state enterprise expanded dramatically as a result of the nationalisation of the electricity sector. Against this, Mediobanca led the merger between Montecatini (chemicals) and Edison (former leading electrical company). In so doing, Montedison was formed in 1966.¹⁰⁹ Soon after the merger operation, the mismanagement of the company led the state-owned ENI and IRI – through the financial holding Sogam – to buy up shares of the company. The process was followed by Mediobanca which obtained a decisive 2% participation in the block syndicate where public and private capitals had 49%. The creation of Montecatini-Edison and its future vicissitudes until the 1990s had Mediobanca as the main protagonist. This operation emphasised two aspects of Mediobanca. First, the institute announced its role of financial engineer for large private companies vis-à-vis the growth of the public enterprise. Second, Mediobanca's investment banking expertise was unique to the extent that it provided funding strategies for private business whilst guaranteeing continuity in the oligarchic ownership structures (Segreto, 1997, 653-655).

In the same years, Mediobanca participated also in a syndicate – together with FIAT, Pirelli, IMI and La Centrale – to solve the crisis of Olivetti, the company which produced Italy's first computer in 1959. The bail-out of Olivetti revealed an aspect which became a major feature of Mediobanca, that is: the scarce interest in the technological and innovative aspects of the companies financed by the institute. In fact, Mediobanca was strictly concerned with keeping firms in good financial conditions, by manoeuvring the ownership structures within the perimeters of the private oligarchies (Segreto, 2008, 805). In the light of this, the information technology division of Olivetti was indeed sold to General Electric. The decision soon

¹⁰⁹The company was initially known as Montecatini-Edison. It was renamed Montedison in 1969 (Marchi and Marchionatti, 1991).

turned into a missed opportunity in the computer revolution (Soria, 1979).

During the 1970s, Mediobanca showed more than ever its ability to secure the ownership assets of private capital in a scenario of global recession. The operation that consolidated the important status acquired by Mediobanca came with the crisis of FIAT, a situation which Cuccia solved in 1976 through the inflow of new capital in the company. Deutsche Bank joined the syndicate together with the controversial entry of Lafico, the financial holding of Colonel Gaddafi. This move was mediated by Lazard Frères and Giovanni Agnelli who won the perplexity of Washington. The operation re-modelled the ownership structure of FIAT, guaranteeing the power of the Agnelli family over the company (Segreto, 2008, 808-809).

Whilst Mediobanca successfully solved the crisis of FIAT, the state-owned apparatus found itself in extreme difficulties. As previously shown, the DC-PSI alliance advanced a plan to industrialise specific areas of the Mezzogiorno through the delocalisation of state-owned companies such as iron and steel, chemicals and petrochemicals. IMI and other public SCIs became heavily exposed to these sectors due to their primary role in the allocation of so-called *credito agevolato* (Zamagni, 2010), a type of subsidised credit that the heavy industry used for its operations in the Southern regions (Marzano, 1979). Both Christian Democrats and Socialists upheld these flows of 'easy money' as part and parcel of their political-economic strategies. In fact, politicians and public managers were connected through linkages of financial support and political protection (Bianchi, 1987). In so doing, at the turn of the 1970s, the relationship between IMI and the system of public enterprise was tightly secured under governmental control. Credit was allocated even in the face of low margins of profits, therefore creating an artificial propensity to invest in the heavy industry despite its critical condition (Canovi, 1986). During the 1970s, authorities attempted to counteract the problem but their measures were belated and ineffective. Quite remarkably, the Bank of Italy forced ordinary banks to buy up bonds from SCIs up to 75% of the overall debt issuance. This decision de facto abolished the 1936 law on banking (Pontolillo, 1980).

Thus, Italian capitalism approached the 1980s in a condition largely unchanged for what concerns the system of ownership and control. To be sure, different strategies were adapted to the various historical circumstances, but the final result was the reproduction of private oligarchic structures as well as the critical over-extension

of state ownership. In this context, Mediobanca played the delicate role of providing strategies that limited the separation of ownership and control for private companies, whilst also mediating the overall public-private equilibria of the Italian political economy as a whole. As shown below, the dynamics of both public and private capitalism assumed new complexities during the 1980s. On the one hand, private capital developed collusive mechanisms to limit the separation of ownership and control in spite of opening up to the stock market. In this regard, the role of Mediobanca was crucial in introducing private oligarchs to the world of equity finance. On the other hand, the system of public enterprise began instead its gradual and final decline. The events concerning the state-owned enterprise were marked by the objection of the Socialists to the restructuring and downsizing undertaken by the top management of IRI. Amidst these events, Mediobanca launched a plan to privatise its own shareholding syndicate in order to decrease public influence on its activities.

3.2.2 The stock-market boom and the fall of the public enterprise

In the early 1980s, after comprehensive strategies of industrial and financial restructuring, companies turned towards the stock market.¹¹⁰ As previously shown, the Borsa did not represent a central dimension of the Italian economy during the post-war period. However, the crisis of the 1970s had considerably affected the capacity of large business to rely on self-funding. What is more, SCIs had become a prerogative of the state-owned sector in its contradictory expansion. Finally, the possibility of taking out loans with commercial banks on a short-term basis – as allowed by the 1936 law on banking – was in many respect an inefficient solution. In these circumstances, equity finance became an attractive opportunity, especially after the introduction of mutual funds in 1983 (Amatori and Colli, 2001, 12-14, 32-33).¹¹¹

As a result, the stock-market index grew from 1694.55 in 1983 to 6767.79 in 1989, with a peak of 7552.86 recorded in 1986. Between 1984 and 1985, the index showed a percentage variation of 94%. Listed companies increased from 140 in 1981 to 223 at the end of the decade (Aleotti, 1990, 228-229). However, this financial expansion

¹¹⁰Throughout the 1970s, large companies cut down labour force, undertook productive decentralisation and improved their technology (Graziani, 1998).

¹¹¹About the introduction of mutual funds in Italy, see Turani (1991).

was not a sign of concrete transformation in the traditional strategies of ownership concentration. Quite the opposite, the growing importance of the stock market in the 1980s was the result of the long-established practice of pyramid-building through which major groups increased the number of related spin-offs listed on the stock exchange (Deeg, 2005*b*, 528). These pyramidal structures were reinforced in their controlling function by a corporate governance legislation inattentive to the necessities of minority shareholders, as well as a system of cross-shareholding alliances and interlocking directorates that diminished the possibilities for hostile takeovers (Brioschi, Buzzacchi and Colombo, 1990).

In sum, the end result was that the growth in equity finance merely reinforced the traditional parameters of business control. The same few groups accounted for virtually the whole market capitalisation. For example, in 1987 the Agnelli empire accounted for over 20% of market capitalisation, followed by the government-owned holding IRI (16.8%), Generali (15.3%), Ferruzzi (11.8%) and CIR Group (7.2%) (Amatori and Brioschi, 2001, 142-143). In the early 1990s, Bank of Italy conducted an in-depth research concerning the structure of ownership and control in the Italian business (Barca et al., 1994; Capra et al., 1994). Comparative analyses were also undertaken for several other European countries (Barca and Becht, 2001). These studies confirmed that corporate ownership and control was extremely concentrated in the hands of families, coalitions, the state and other non-financial companies through cross-shareholding alliances. In difference to other countries, both institutional investors and private banks held no substantial stake in corporate ownership (Bianchi, Bianco and Enriques, 2001, 155-156). To illustrate the peculiarity of the Italian case, figure 3.1 shows the complex structure of the Agnelli empire (FIAT) in 1996. As it is clear, Agnelli controlled an empire of twenty-eight companies through the financial holding IFI. Fifteen of the twenty-eight companies were listed on the stock market.

Mediobanca played a fundamental role in the ownership strategies of Italian capitalism during the 1980s. The institute directed the IPOs of 23 amongst the 98 companies which were newly listed in the period 1981-1993, as well as the 30% of share capital increases in companies that were already listed (De Cecco and Ferri, 1996, 109-119). What is more, Mediobanca increased the stability of the private oligarchies by favouring voting syndicates to secure mutual protection (Amatori and

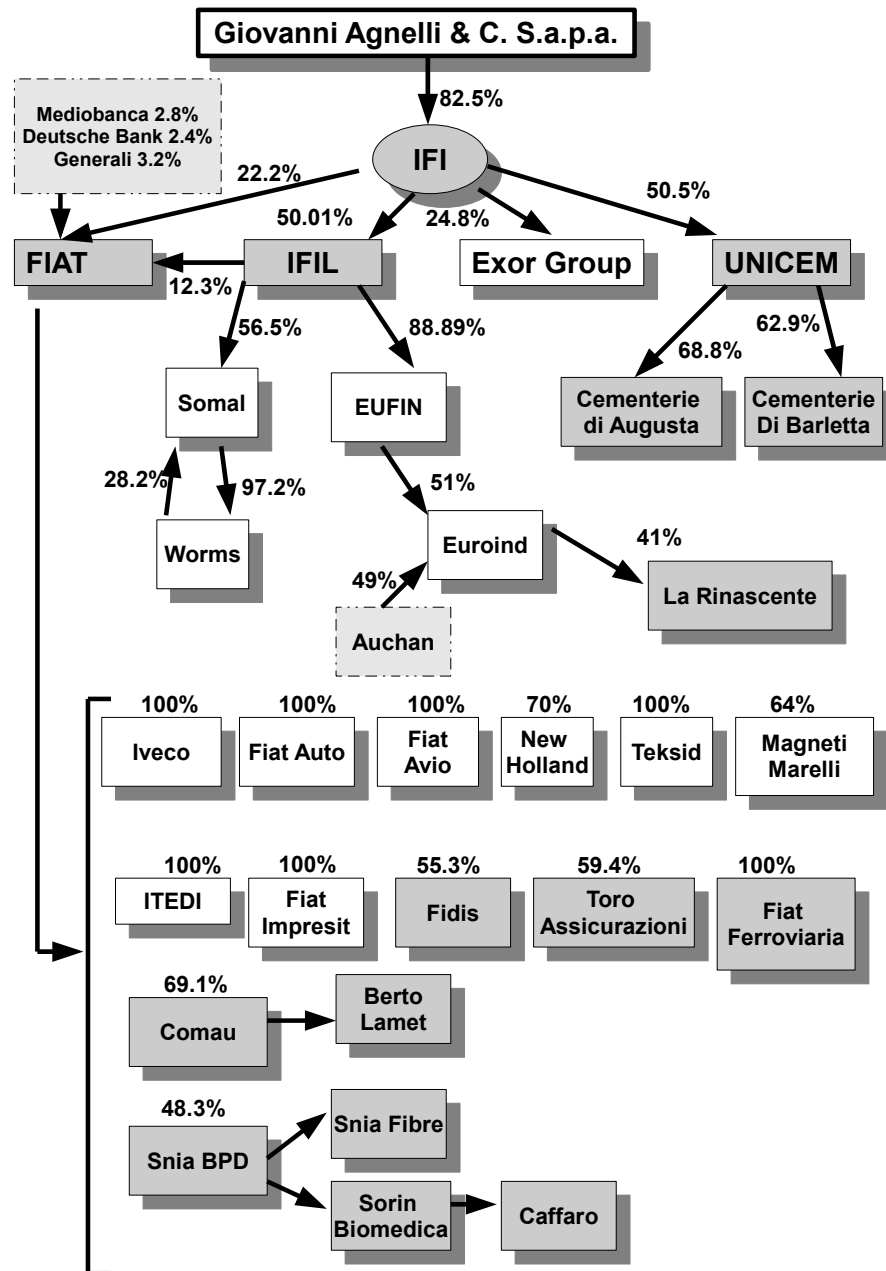


Figure 3.1: Ownership structure of the Agnelli empire, 1996.

Source: adapted from Bianchi, Bianco and Enriques (2001, 155). Grey rectangles are listed companies. White rectangles are non-listed companies. Dotted and dashed rectangles are other important shareholders.

Colli, 2001, 20-21). However, the most significant operation directed by Mediobanca at the interstice between private and public capitalism was another episode of the Montedison saga.

As already seen, the chemical industry was heavily hit by the 1970s crisis, an aspect which led the state-owned holding IRI and ENI to leave the shareholding syndicate of Montedison in 1981. As a result, Montedison was now in the hands of private shareholders. In this situation, Mediobanca organised a syndicate – under the control of the financial holding Gemina – where the interests of oligarchs such as Agnelli, Pesenti, Pirelli, Orlando and Bonomi converged and secured Montedison's assets. What is more, Cuccia promoted the manager Mario Schimberni as the company's chief executive officer. However, Schimberni aimed at acquiring margins of autonomy from the blockholders by turning Montedison into the ideal public company with over hundred thousand minority shareholders. Of course, the objectives of Schimberni represented an anomaly in a country where oligarchs and the state controlled the large corporate world. In fact, his ambitions came to a halt when the Ferruzzi group – a new actor involved in the agro-industry – became the majority shareholder of Montedison in 1987.¹¹² Once Ferruzzi – under the leadership of its chief executive Raul Gardini – obtained control over Montedison, it advanced a far-reaching plan for the establishment of a public-private joint-venture in the chemical sector. This led to the creation of Enimont in 1988 in which the state-owned ENI and Montedison held 40% each. In so doing, an alliance between private and public – which could have strengthened the global competitiveness of the Italian chemicals in several product lines – came into being. But, conflicts between the two parts soon led to a stalemate and eventually ended the Enimont project. The Ferruzzi Group left Montedison and Mediobanca drew a recovery plan for the severely indebted company (Segreto, 1998, 463-464).

During the 1980s, besides its role in the stock-market boom and the events concerning Montedison, Mediobanca designed also a project to privatise its own ownership structure in order to reduce public influence over the institute. The plan faced the opposition of many political forces and, above all, the management of IRI. In fact, the state holding owned the three public banks – COMIT, CREDIT, Banco di Roma – of which share ownership in Mediobanca was supposed to be decreased

¹¹²For a chronicle of those days' events concerning Montedison and Schimberni, see Suro (1987). About the rise and fall of the Ferruzzi family, see Bonanno and Constance (2008, chapter 3).

in favour of private actors (Segreto, 2008, 813-814). The privatisation was finalised in 1988 and implied an ownership syndicate of roughly 25% each between public and private actors. The remaining half of Mediobanca shares floated on the market (Brioschi, Buzzacchi and Colombo, 1990, 190).

For what concerns the system of public enterprise, the latter had functioned as a ‘social buffer’ against the employment difficulties of the 1970s (Bianchi, 1987, 279). As a result, its economic and financial situation worsened dramatically. At the same time, the system became exposed to political pressures with increasing corruption and illegal practices penetrating its internal mechanisms (Toninelli, 2004, 60). At the turn of the 1980s, the Ministry of State Shareholdings stated in its report that:

[...] the system of public shareholdings, that is, the main instrument of industrial policy organised in our country, has become terribly costly in terms of collective resources absorbed, while the results are worsening day by day [...] If there is a clear will to reshape the Public Shareholding system a better managerial skill is necessarily associated with a government behaviour which must be more respectful towards the promises made when the public enterprise system was asked to play a precise role.
(cited in Bianchi 1987, 281, 282)

Premised on these considerations, IRI underwent a decade-long process of restructuring and downsizing under the leadership of Romano Prodi, a professor of economics who was appointed as President of the public holding in 1982.¹¹³ In particular, IRI sold the car-manufacturer Alfa Romeo to FIAT in 1986 (Saulino, 1986) and Finisider was liquidated in 1988 (Borriello, 1988). The management also attempted to sell SME (food processing) to the CIR Group in 1985. But, the sale was eventually blocked and became a controversial case of corruption (Economist, 2003). Finally, minority share packages of IRI’s biggest companies were also listed on the stock exchange (Bianchi, 1987, 283).

The crucial aspect to highlight with regard to the system of public enterprise during these years is the struggle between Prodi and the government led by the

¹¹³Prodi was a member of DC. Before being appointed at IRI, he was Minister of the Industry, Commerce and Craftsmanship (1978-1979). Prodi chaired IRI until 1989 and then again in 1993-1994. As the next chapter shows, he became President of the Council of Ministers (1996-1998; 2006-2008). In the period between the two Italian presidencies, he was President of the European Commission (1999-2004). See <http://www.romanoprodi.it/> and http://ec.europa.eu/archives/commission_1999_2004/prodi/index_en.htm [both accessed on December 30, 2012].

Socialist Bettino Craxi. On the one hand, Prodi attempted to reintroduce those mechanisms of managerial autonomy vis-à-vis politics that the DC-PSI alliance had dismantled since the late 1950s. On the other hand, Socialists opposed any effort which was directed at diluting political influence over IRI. In fact, PSI intended to use the system of public enterprise as an economic and financial pillar in support of its political strategies. In other words, just like DC had done in the late 1950s, Socialists saw the state-owned sector as an entity to be controlled for purposes of power consolidation (Bianchi, 1987, 284-285). This tactical aspect explains the political-economic imperatives behind the corrupt networks that PSI weaved in the period.

3.3 Towards the 1990s season of reforms: the formation of a neoliberal technocratic elite

To recapitulate, this chapter has examined the history of Italian capitalism and its uniquely concentrated structure of ownership and control since the early industrialisation. The imperative to secure ownership and control in the hands of few blockholders encouraged the formation of several centres of gravity which coordinated shareholding strategies and calibrated the equilibria between private business and public enterprise – a function particularly performed by Mediobanca. This condition of restricted suffrage further accentuated during the 1980s, a period which was characterised by the collusive expansion of stock-market trading and the controversial downsizing of the public enterprise.

However, this scenario was about to change dramatically under the influence of intertwined external and domestic dynamics. In fact, whilst the process of European integration applied strong pressures in favour of liberalising reforms, domestic actors ‘cultivated’ these tendencies internally (Deeg, 2010, 174, 186). This final section examines the formation of a technocratic elite within state institutions such as the Bank of Italy and the Ministry of Treasury.¹¹⁴ It shows how these actors put forward

¹¹⁴Since the post-war period, the Italian Ministry of Treasury was one of the four ‘economic’ Ministries together with the Ministry of Finance, the Ministry of Budget and Economic Planning, and the Ministry of State Shareholding. The Ministry of State Shareholding was closed down in 1993. The Ministry of Treasury merged instead with the Ministry of Budget and Economic Planning in 1996, forming the Ministry of Treasury, Budget and Economic Planning. In 2001, the latter merged again with the Ministry of Finance, eventually forming the current Ministry of

a pro-market critique of Italian capitalism through which they aimed at modernising its institutional foundations.¹¹⁵ In the early 1990s, taking advantage of a general consensus for European unification, technocrats linked Italy to EMU and used it as an external discipline to overcome domestic failures (Dyson and Featherstone, 1996; Sbragia, 2001).

Many influential scholars advanced rigorous pro-market critiques of Italian capitalism since its early industrialisation. Most notably, the politician and economist Luigi Einaudi (1911) denounced the concentrated ownership structure of the Italian big industry already during the Giolitti era.¹¹⁶ Later on during the 1950s and 1960s, a group of influential intellectuals gathered around the journal *Il Mondo* and pursued a battle for the reform of company law as well as the adoption of antitrust regulation (Marchetti, 2001). However, in spite of these important critiques, it was only once the system of public enterprise fell into crisis during the 1970s that the discourse of neoliberalism began to acquire considerable weight at the Bank of Italy and the Treasury Ministry. In this regard, Pierluigi Ciocca (2005, 36-37) contextualises the rise and consolidation of neoliberal reformism during the central-bank governorships of Paolo Baffi (1975-1979) and, in particular, Carlo Azeglio Ciampi (1979-1993). According to Ciocca:

[t]he central bank was convinced of the urgent need to strengthen the response of resource allocation and the financial structure to the economic crisis of the 1970s [...] The critique focused on the mechanisms

Economy and Finance. See <http://www.mef.gov.it/ministero/di-piu-mef/la-storia.html> [accessed on December 30, 2012].

¹¹⁵Scholars contributing to the debate on varieties of capitalism have accurately examined the broad institutional processes of market-oriented transformation in Italy. According to this research programme, Italy was a case of ‘dysfunctional’ *state capitalism* during the post-war period (Della Sala, 2004). In fact, compared to models of *market capitalism* (US, UK) and *managed capitalism* (Germany), the Italian state played a more extensive and programmatic role in areas such as government policies, inter-firm relations, financial affairs, and labour relations (Schmidt, 2002). In some respects, Italy was similar to France but with the crucial difference that the Italian case was paralysed by factionalism and patron-client relations. Since the early 1990s, this model of dysfunctional state capitalism has been subject to profound institutional change in the wider context of globalisation and European regionalisation. Yet, in spite of this rupture with the past, the literature on varieties of capitalism tends to agree that the Italian case did not converge to either a market-based or a managed model. As Vincent Della Sala (2004, 1041) argues, Italian capitalism “adopted and mimicked elements of both without becoming either. This is because many of the political and economic factors that were at the heart of the model in the post-war era remain in place.”

¹¹⁶Einaudi served as President of the Republic between 1948 and 1955. See <http://www.quirinale.it/qrnw/statico/ex-presidenti/Einaudi/ein-biografia.htm> [accessed on October 26, 2012].

propagating inflation: 100 per cent indexations and the loss of control over the public finances. In the 1980s the first of these would be defused, the idea of wages as an ‘independent variable’ overturned; but the second degenerated into the dissipation of public money. Baffi and Ciampi were among the few to grasp, early on, that [...] the ultimate limit to the capacity to respond to shocks lay in the spheres that ought to have overcome the inconsistency between relative prices and the use of resources: the markets, imperfect; the state’s presence, redundant; and the whole model of Italy as a mixed economy, inadequate.

As it is clear from this extract, technocrats were haunted by the collective memory of the economic indiscipline which characterised Italy during the 1970s (Dyson and Featherstone, 1996, 274).¹¹⁷ To their dismay, the country still lacked concrete market discipline by the mid-1980s – especially for what concerned the ‘dissipation’ of public finance. With this in mind, technocratic elites – strong in their economic expertise – advanced a critique of Italian capitalism which was centred on few key ideas. First, it was necessary to restructure public finance and reduce the growing level of debt (Giavazzi and Spaventa, 1988). Second, the system of public enterprise was inefficient in the allocation of productive resources. Political parties imposed non-economic objectives on public managers and hindered a correct response to market changes and technological innovation (Goldstein, 2003, 1). For this reason, the system of state-owned enterprise had to be downsized and privatised (Scognamiglio, 1990). To this two aspects should be added a third one which emerged particularly during the 1990s: rendering the system of corporate governance more attentive to shareholder value (Disiano-Preite, 1997). This would have improved the competitiveness of Italian business (Barca, 1996). These ideas were very powerful and disturbed those mechanisms upholding conservative power structures in Italy. Why was this the case?

To begin with, downsizing and privatising the public enterprise implied hindering the normal reproduction of *partitocrazia* which, as already seen, depended on the clientelistic exploitation of the state-owned apparatus. Although these conditions

¹¹⁷Technocrats refer to experts in specific fields – e.g. economics, law and so on – who apply their high-level knowledge to government affairs either as technical advisers or unelected decision-makers. For a review of the debate on technocracy, as well as an interesting study about technocrats in Chile, see Silva (2008).

had always existed in Italy, they acquired even more systemic and corrupt traits during the 1980s (Della Porta and Mény, 1995). To a large extent, the situation was due to the Socialists' thirst for resources to be deployed in their ambitious plan of dominating the national political scene in spite of their relatively small electorate. As Paul Ginsborg (1996, 23-24) puts it,

Christian Democrats, and often exceeding them, the Socialist Party of Bettino Craxi played a leading role in the systematisation and theorisation of corrupt practice. This was the period when kickbacks on public contracts became a highly organised affair, when party and personal financing flourished directly from the illegal use of political prerogative.

In addition to this, the objective of reducing public debt entailed removing government expenditure as an essential tool of mass consensus. In fact, especially during the years of the Craxi administration (1983-1987), public spending was instrumental to creating an atmosphere of *enrichissez-vous* amongst large strata of privileged groups (Pasquino, 2000, 79).

For what concerns instead private capitalist oligarchies, the shareholder-oriented transformation of the financial system implied an attack on their concentrated structure of ownership and control. More transparent rules of corporate governance, as well as an efficient and liquid stock market, would have ensured equality of rights amongst shareholders and less opportunities to weave cross-shareholding alliances. In a word, a growing call for meritocracy in corporate ownership and control endangered the traditional practices of private capitalism in Italy (McCann, 2000, 49-50).

In the early 1980s, neoliberal reformism was still relatively weak. To be sure, many forces were already in motion. For instance, large companies had undergone financial, technological and territorial restructuring in order to cut productive costs whilst breaking up labour resistance (Graziani, 1979). Furthermore, industrial relations were to a large extent normalised after the turmoil of the previous decade (Bevacqua and Turani, 1978). Finally, Italy had joined the European Monetary System (EMS) in December 1978, although with a wider fluctuation band of 6 per cent and the so-called 'parallel measures' for less stable economies (Quaglia, 2002, 159-190). Yet, in spite of this early reformist trend, conservative interests still opposed the introduction of concrete market reforms. In particular, the Craxi cabinet

offered the Italian society a unique way to address the aesthetics of rampant individualism, consumerism and entrepreneurship, whilst reinforcing at the same time the system of *partitocrazia* and its dependence on unrestrained public expenditure (Ginsborg, 2001, 150-157). Similarly, big private capital turned to the Milan Borsa as the symbol of entrepreneurial progress and modernisation.¹¹⁸ But, as already seen in the previous section, companies did so whilst remaining within the boundaries of traditionally collusive strategies.

The practices and discourses of neoliberalism began to gain influence in the second half of the 1980s. During this time, the process of European integration revealed a new impetus under the European Commission Presidency of Jacques Delors (1985-1994).¹¹⁹ In February 1986, the signing of the Single European Act fixed the objective of creating a common market for goods, services, labour and capital by the year 1992. The importance of creating a single market amongst European countries was already acknowledged in the Treaty of Rome (1957), but progress had been slow throughout the post-war period. This was due to the fact that market integration – especially for what concerns the realm of finance and capital mobility (Howells and Bain, 2005, 448-449) – would have undermined the institutions of European welfare states. However, the situation had changed considerably by the early 1980s. In fact, the mixed economy entered a profound crisis which opened up a struggle over the future of Europe. In this regard, as Bastiaan Van Appeldoorn (2002, 78-82, 158) shows, the Single European Act emerged out of a hegemonic compromise between the most globalised fractions of European capital (both industry and finance) and the more inward-oriented industries. Whilst the former upheld the rising neoliberal discourse, the latter put forward instead a neo-mercantilist narrative that saw the single market as a protected space vis-à-vis global competition. Together, neoliberalism and neo-mercantilism displaced the plan of building a Europe-wide social market democracy.

The same hegemonic configuration which led to the single market was also crucial in launching the wider and more ambitious project of EMU (Bieling, 2003,

¹¹⁸Stock-exchange practices and technology perfectly epitomised what journalists dubbed *la Milano da bere* ('the Milan you can easily drink'). Borrowed from the advertisement of a popular after-dinner liquor, such expression reflected the role of Milan as the capital of the rising economic sectors such as marketing, fashion and finance (Foot, 2001, 166).

¹¹⁹Unless otherwise referenced, the following analysis concerning the historical documentation of EMU is based on the institutional web site of the European Commission at http://ec.europa.eu/economy_finance/emu_history/part_a.htm [accessed on December 30, 2012].

208). In 1989, the ‘Delors report’ proposed the practical steps for undertaking a process of economic and monetary integration. This report laid the groundwork for the intergovernmental conference on EMU which opened alongside the other IGC on the political union in December 1990.¹²⁰ The IGC on EMU agreed that the path towards a single currency entailed i) a European central bank defining and implementing monetary policy, assuring price stability and acting autonomously from political pressures; ii) close convergence of member states’ economic policies based on budget discipline; iii) transforming the European Currency Unit (ECU) from a basket unit into a true currency.¹²¹ The two IGCs were closed at the Maastricht Summit in December 1991. They resulted in the Treaty on the European Union (EU) which established the EU in its three-pillar structure and amended the old European Economic Community (EEC) Treaty to include the EMU articles.¹²² Member states were to undertake the process towards EMU in three stages. These would gradually lead to economic convergence, price stability and discipline in government finance before permanently fixing the respective national currencies in a monetary union.¹²³ Member states had to adhere to five convergence criteria in order to qualify for the

¹²⁰Delors chaired the ad-hoc committee of the twelve central bank Governors which prepared the report. The latter was accepted at the Madrid European Council (June 1989). Here, it was decided to begin the first stage of EMU in July 1990 – when the liberalisation of all capital movements also came into force. In December 1989, the European Council eventually took the decision to convene the IGC on EMU before the end of 1990.

¹²¹The currency was renamed the ‘euro’ during the Madrid European Council in December 1995.

¹²²The Maastricht Treaty was signed on February 7, 1992 and came into force on November 1, 1993. EEC indicates the common market established in 1957 (Treaty of Rome). EEC was renamed European Community (EC) in 1992 (Treaty of Maastricht), becoming part of the first of the complex three pillars of the EU together with the European Coal and Steel Community (ECSC) and the European Atomic Energy Community (EURATOM) – the other two pillars being the Common Foreign and Security Policy (CFSP) and Police and Judicial Co-operation in Criminal Matters (PJCC). The 2009 Lisbon Treaty replaced this overly complicated three-pillar structure by creating a common body (the European Union). See Nugent (2010). To simplify, this thesis uses the term ‘Europe’ regardless of the different phases of European integration.

¹²³In brief, the first stage started with the liberalisation of capital movements (July 1990). During the first stage, all member states were to become full members of the EMS in its narrow band, increasing also the mutual coordination of domestic monetary policies. The second stage began in January 1994 and implied the establishment of the European Monetary Institute which monitored the correct use of fiscal and monetary policies by member states. Finally, the third stage entailed the replacement of the European Monetary Institute with the European Central Bank. The latter formed the European System of Central Banks (ESCB) together with the national central banks. At this point, exchange rates were permanently fixed and national currencies were eventually replaced by the single currency. Member states had to decide before December 1996 when this third stage would begin. If no date was set by the end of 1997, it would nonetheless start as of January 1, 1999. See Howells and Bain (2005, 467-468).

EMU membership.¹²⁴

Italy looked at the process of European unification very positively. To begin with, public opinion was supportive of Europe and considered the latter as the benchmark for domestic modernisation (Quaglia, 2011; Ginsborg, 2001, 168). This aspect is remarkable if we take into account the restrictive economic measures that the Italian population had to deal with in order for the country to join EMU. Furthermore, business elites also showed strong pro-European opinions. In particular, big private capital saw Europe as an opportunity for introducing fiscal and monetary orthodoxy, therefore disciplining both state intervention in the economy and, above all, the bargaining power of the trade unions (Talani, 2003).¹²⁵ Remarkably, private capital was not very much concerned – at least, until the mid-1990s – about how EMU membership implied also creating a regime of market transparency which undermined their strategies of oligarchic control.¹²⁶ Paradoxically, the very same politicians who epitomised the immobility of *partitocrazia* were also strong supporters of European unification. For example, DC-leader Giulio Andreotti advocated the entry of Italy in the two-band mechanism of the EMS in 1978 (Quaglia, 2002, 165-168). Furthermore, he again agreed with Treasury Minister Carli and the Governor of the Bank of Italy Ciampi in their decision to place Italy within the narrow band of the EMS in 1990 (Scalfari, 1990).¹²⁷ Even Craxi played a fundamental role in steering the process that led to the Single European Act. In June 1985, during the Milan European Council, he called the vote – against Margaret Thatcher’s opposition – which established an intergovernmental conference on the single market (Ginsborg, 2001, 244-245). This pro-European attitude of the political class was certainly surprising considering that

¹²⁴Briefly, these criteria were: i) inflation rate must be no more than 1.5% higher than the average of the three ‘best performing’ member states; ii) the government deficit-to-gross domestic product (GDP) ratio must not exceed 3% at the end of the previous fiscal year; iii) the debt-to-GDP ratio must not exceed 60% at the end of the previous fiscal year; iv) member states must not devalue their currencies for two consecutive years as part of the EMS; v) the nominal long-term interest rate must not be higher than 2% relatively to the three lowest inflation members.

¹²⁵It is important to note that monetary orthodoxy came with a cost for business elites: the removal of devaluation as an important strategy for the Italian industry. This aspect was particularly significant for export-oriented SMEs, which nonetheless looked at EMU positively as it was expected to lower domestic interest rates. SMEs would have benefited from it since they were heavily dependent on loans to finance their activities (Amyot, 2004, 59).

¹²⁶It is possible that such inattention to market transparency was due to the fact that, although Italy was a particularly virulent case of concentrated ownership, other European countries presented similar corporate structures. See Barca and Becht (2001).

¹²⁷As already seen, Carli was Governor of the Bank of Italy in the period 1960-1975. He was Treasury Minister from 1989 until 1992.

Europe entailed drastic changes to their way of life.¹²⁸ Despite the inherent dangers, political leaders recruited key technocrats in government affairs since the late 1980s. As Ginsborg (2001, 253) pointed out, “much of the history of Giulio Andreotti’s last two governments was an essay in politics of this sort: not reforms that served to keep the storm on the distant horizon, but rather brought it nearer.”¹²⁹

Hence, amidst a general consensus for European integration, market-oriented reforms were gradually introduced in the Italian political-economic landscape. For instance, after the lira joined the narrow band of the EMS in 1990, all restrictions to the free flow of capital were removed.¹³⁰ This reduced considerably the authorities’ ability to manoeuvre monetary policy independently from market forces. As Carli explained in rather populist terms, the freedom of capital movements gave citizens the ability to control politicians by choosing in which jurisdiction to invest their own savings (Polidori, 1990). In the same year, the ‘Amato’ law transformed public banks into joint-stock companies by allowing the sale of up to 49% of their shares to private investors.¹³¹ Yet, the majority of banks (mostly savings banks) remained under the influence of local administrations through the so-called *fondazioni*, the non-profit

¹²⁸It is logical to question whether Italian politicians understood the consequences of their actions, especially with respect to EMU and its tight restrictions on public finance. In this regard, on the basis of a press survey and interviews, Lucia Quaglia (2002, 218-220) provides several explanations regarding the attitude of the political class towards monetary integration. Let us report the most relevant ones. First, it is possible that politicians neither debated nor rejected EMU as Italy had already joined the EMS in 1978. In other words, past decisions had set the path for future commitments. Second, as the same Minister Carli (1993, 437) argued, the Italian political class lacked the economic expertise to properly assess the implications of a monetary union. Third, there was the belief that the criteria could be ‘softened’ to fit the Italian condition. Fourth, ‘shrewd and seasoned’ politicians perfectly understood EMU’s drastic implications. However, they believed that adjustments in Italy were necessary. Hence, by undertaking them ‘in the name of Europe’, would have diluted their ensuing political and social costs. Taking into account the diversity of explanations, Quaglia concludes that different reasons held for various political forces. Even in the case of single politicians, their individual views might have reflected several concerns.

¹²⁹Andreotti led the last two governments of the so-called *pentapartito* alliance from July 1989 to April 1992. DC and PSI formed this governing alliance in 1981 together with three small liberal parties: Partito Socialista Democratico Italiano (Psdi), Partito Repubblicano Italiano (PRI), and Partito Liberale Italiano (PLI). See Pasquino (1995a).

¹³⁰Cf. ministerial decree April 27, 1990 at http://www.dt.tesoro.it/export/sites/sitodt/modules/documenti_it/prevenzione_reati_finanziari/normativa/DM-27-aprile-1990.pdf [accessed on December 30, 2012].

¹³¹Cf. law no. 218, July 30, 1990. In Italy, laws and decree laws are often nicknamed with the name of their promoters – in this case, Giuliano Amato. A professor of constitutional law and member of the Socialist Party. Amongst other tasks, he was Treasury Minister (1987-1989; 1999-2000) and President of the Council of Ministers (1992-1993; 2000-2001). See <http://www.giulianoamato.it/biografia> [accessed on December 30, 2012].

bodies which held the newly-issued shares (Deeg, 2005*b*, 530).¹³² The significance of the Amato law stems from the fact that it took the first step in the far-reaching privatisation of the state-owned sector which, as the next chapter shows, was implemented throughout the 1990s (Goldstein, 2003). Other important reforms included the long-awaited antitrust regulation, the law on insider trading and, finally, the stock-market reform.¹³³ The latter dismembered the stockbrokers' executive committees (Comitati Direttivi degli Agenti di Cambio) which had directed the national stock exchanges since 1932.¹³⁴ It established instead the Milan-based stock exchange board (Consiglio di Borsa) which paved the way for the stock-market modernisation, including: the shift from open outcry to electronic trading in 1994; the 1997 centralisation of national exchanges in the Milan-based market; the privatisation of the stock exchange which implied the dismantling of the Consiglio di Borsa and the creation of Borsa Italiana, a joint-stock company that began its operations in January 1998. The most immediate and critical aspect of the 1991 stock-market reform was that stockbrokers lost their monopoly over share trading and their professional category ceased to exist. Brokerage firms – known by the acronym of SIM (*società di intermediazione mobiliare*) – were instead authorised to operate both on their own behalf and on behalf of third-parties, supposedly increasing market transparency and price competitiveness (Petrini, 1990).

Besides these early reforms, it was particularly during the intergovernmental conference on EMU that technocrats gained considerable decision-making power over national affairs. As Kenneth Dyson and Kevin Featherstone (1996, 274-279) explained, political leadership was limited in ensuring that Italy remained an active participant in the process of European integration. Within this wider framework, a small technocratic elite consciously negotiated EMU to impose an external discipline on the country's status quo. To be sure, the negotiations were beyond the control of Italian actors, being dominated instead by the Franco-German axis. But, Italian technocrats willingly tied the Italian economy to the Maastricht convergence criteria

¹³²As Deeg (2005*b*, 530) explains, the Amato law was highly debated since most of the banks were connected to networks of patronage. In this sense, *fondazioni* smoothed the process of bank privatisation by ensuring certain margins of continuity in the political influence over banks.

¹³³Cf. respectively law no. 287, October 10, 1990; law no. 157, May 17, 1991; law no. 1 January 2, 1991.

¹³⁴Unless otherwise referenced, the following summary concerning the modernisation of the national stock exchanges is based on the institutional web site of Borsa Italiana at <http://www.historytour.it/> [accessed on December 30, 2012].

in order to limit the ability of manipulating domestic public finance in line with the necessities of *partitocrazia*.¹³⁵ As a result of EMU, Italy was irrevocably linked to the market-oriented dynamics of Europe. On the very same day in which the Maastricht Treaty was signed, the ‘Carli’ law enacted the independence of the Bank of Italy from the Treasury.¹³⁶ Since 1981, the Treasury no longer obliged the central bank to finance its necessities either through overdraft in the Treasury’s account or via the purchase of government securities (Epstein and Schor, 1989, 150). Now, the Bank of Italy was granted full autonomy to fix interest rates.

3.4 Conclusions

This chapter has shown that Italian capitalism historically evolved through the construction of complex equilibria between private business oligarchies and a large public enterprise (Segreto, 1998). This liaison between the state-owned sector and private capitalism secured ownership in the hands of the state and the oligarchs, producing a scenario which – both in its public and private dimensions – reached its most collusive and corrupt traits during the 1980s (Ginsborg, 2001). In this context,

¹³⁵Dyson and Featherstone (1996, 277-279) showed that the total number of personnel involved in the EMU negotiations was no more than 16 people. The Socialist Gianni De Michelis (Foreign Minister) convened a steering group in preparation for the six-month Italian Presidency of the Council of the EU (July-December 1990). Part of this steering group were: Umberto Vattani (Diplomatic Counsellor to the Prime Minister); Raniero Vanni d’Archirafi (Director-General for Economic Affairs at the Ministry of Foreign Affairs); Tommaso Padoa-Schioppa (Deputy Director-General, Bank of Italy); Mario Sarcinelli (Director-General, Ministry of Treasury). These actors played a central role during the period of the Italian presidency. After these six months, Mario Draghi replaced Sarcinelli in February 1991. Giovanni Jannuzzi substituted instead D’Archirafi in July 1991. Furthermore, Rocco Cangelosi served as the personal representative for the Foreign Minister De Michelis in both the IGC on EMU and that on political union. Draghi was instead the personal representative for the Treasury Minister Carli at the IGC on EMU. This implied that when the IGC met frequently at the level of officials, Draghi and Cangelosi led the Italian team. They were assisted by Augusto Zodda, Draghi’s deputy, and Francesco Papadia (support staff for Padoa-Schioppa, Bank of Italy). In addition to this, Andreotti attended as the Prime Minister, whilst Ciampi took part in the negotiations of the Committee of Central Bank Governors. Finally, Lorenzo Bini-Smaghi was an assistant to Padoa-Schioppa, Fabrizio Saccomanni to Ciampi and Roberto Nigido to Vanni d’Archirafi. According to Dyson and Featherstone, the crucial aspect of the Italian delegation was that Andreotti and De Michelis were not particularly interested in the policy content of EMU, being simply keen to secure Italy’s participation in the project. Carli was instead very old and ill. He attended only the IGC on EMU when it met less frequently at the ministerial level. This means that Draghi, Vattani and Padoa-Schioppa played the most important role in the negotiations. However, whilst Vattani’s intervention was limited to diplomatic affairs, Draghi and Padoa-Schioppa emerged as the key experts on EMU.

¹³⁶Cf. law no. 82, February 7, 1992.

neoliberal technocrats – which enhanced their agential power within state institutions such as the Bank of Italy and the Treasury Ministry – advanced a powerful critique of the country’s political-economic establishment. Taking advantage of a general consensus which favoured Italy’s participation in Europe, these actors tied Italy’s destiny to EMU. In so doing, they established an external constraint on the system of *partitocrazia* and the dissipation of public finance (Dyson and Featherstone, 1996).

The next chapter shows how unelected technocrats captured the Italian executive as of 1992. In so doing, they reinforced their power vis-à-vis the Parliament and the political parties (Sbragia, 2001, 81). As a senior observer commented, the Bank of Italy and the Treasury became “the import agents and the authorized interpreters of the austere market sentiment. The relative power of both institutions (vis-à-vis markets) [...] declined, but the relative power of their technocratic heads [...] increased vis-à-vis that of the ministers” (cited in Dyson and Featherstone 1996, 296). In 1996, centre-left politicians embraced the strategies that technocrats had already undertaken. In so doing, a neoliberal reformist coalition came into being and embarked on a dramatic fight in order to conform Italy with the Maastricht convergence criteria. At the same time, this coalition implemented reforms that aimed at modernising the domestic financial system and corporate governance (Deeg, 2005*b*). The significance of derivatives emerged in Italy as part and parcel of these events.

Chapter 4

Deriving a normal country

This chapter looks at the emergence and consolidation of derivatives-based risk management in Italy. It shows that Italian neoliberal reformists deployed this innovation as a crucial factor in their strategies vis-à-vis conservative forces. For this reason, modern derivatives acquired distinct traits in relation to the uniqueness of Italian power relations. Furthermore, whilst neoliberal reformists unfolded their strategies in the attempt to make Italy a modern market democracy (a normal country), other actors adopted derivatives practices for their own requirements. Paradoxically, municipalities as well as the Agnelli family embraced derivatives in order to oppose the very same constraints stemming from neoliberal reforms.

The chapter is outlined in four main sections. First, the analysis focuses on the marketisation of public-debt management as the major incentive to the emergence of derivatives in Italy. Over the course of the 1980s, public debt increased dramatically, the interest payments of which absorbed a substantial portion of government expenditure. Technocrats developed all possible strategies in order to reduce such costs, whilst becoming impatient towards the system of *partitocrazia* and its inability to rein in the deficit. In this context, technocrats began renovating the management of public debt in a market-oriented guise. This shift entailed the adoption of new practices and technology on primary and secondary markets through which the Treasury could develop its policies of active debt management. Technocrats believed that this newly renovated scenario would have helped save on the debt costs. Derivatives practices were integrated within this public-debt marketisation as instruments which supposedly made government bonds more attractive to investors.

The second section focuses on the period 1992-1999. Once technocrats captured

the executive power in the first half of the decade, they implemented neoliberal reforms systematically. These reforms were done in line with the objective of fighting for Europe. In particular, technocrats normalised labour relations in order to curb inflation. In addition to this, they cut down government expenditure to stabilise public finance (Sbragia, 2001, 81). They also undertook a first round of privatisation and, finally, they reintroduced universal banking. In 1996, the Olive Tree coalition got to power and reinforced these neoliberal measures with the objective of bringing government deficit down to 3 per cent of the GDP – a threshold which would have secured Italy a place in the EMU project. It is in this context that both technocrats and centre-left politicians adopted derivatives as crucial to their strategies. First, the Treasury and the Bank of Italy encouraged Long-Term Capital Management and other arbitrage desks to engineer interest-rate convergence between Italian and German bonds via OTC derivatives markets (Dunbar, 2000, 153). This battle for convergence lasted from the late 1993 until 1997. Second, the Olive Tree coalition not only continued this battle, but it also arranged a very unique currency swap which window-dressed the 1997 budget deficit (Piga, 2001, 122-129).

The third section explores a parallel project which centre-left politicians and technocrats implemented in the second half of the 1990s: the modernisation of Italian finance in line with the ideology of shareholder value. This was done in order to eradicate the oligarchic structure of Italian business. However, by emphasising the enabling qualities of the newly developed institutions and discourses (Knafo, 2010, 503), the analysis shows that the construction of this shareholder-oriented regime of corporate governance did not merely restrain corporate oligarchies. On the contrary, it also opened up opportunities to use newly available resources in a tactical sense. In this regard, derivatives were one of the new and most powerful tools to be adopted for purposes of oligarchic control. In fact, as the case of FIAT shows, equity swaps played a fundamental role in keeping corporate ownership tight in the hands of the Agnelli family.

Section four examines instead the controversial use of swaps by local authorities. The analysis explains that municipalities entered into swaps contracts as part and parcel of a highly strategic move which often transcended economic rationality: to circumvent the budget squeeze imposed by the EU-inspired pact of internal stability. Similarly to the FIAT affair, the events concerning municipalities demonstrate how

the construction of new institutions and discourses – in this specific example, the dismantling of the state-centred system of local finance – enabled actors to adopt the newly available resources in order to manipulate the constraints they were initially exposed to.

4.1 Setting the stage: the renovation of public-debt management

The institutions and discourses surrounding the use of derivatives acquired a significant role in Italy once the authorities began to marketise the practices of public-debt management. According to the mainstream argument, a market-oriented approach to public debt entailed developing efficient primary and secondary markets in order to guarantee a stable flow of funds to the government, at minimum borrowing costs and with an acceptable level of risk (Oecd, 2002; IMF, 2003). However, by undertaking this change, the risk of debt service was expected to increase since markets were more volatile than the services provided by syndicate banks. As a result, derivatives were put forward as instruments which smoothed price fluctuations and improved the informational efficiency of cash markets (De Broeck, Guillaume and Van der Stichele, 1998, 10-13). How did this renovation of public-debt practices occur? What role did derivatives play?

Italian technocrats advanced the necessity to contain the expansion of public debt during the 1980s. As already seen, this was the most crucial point within their neoliberal critique of Italian capitalism. Public debt grew considerably throughout the decade and eventually went beyond 100 per cent of the debt-to-GDP ratio by the early 1990s (figure 4.1). To be sure, the problem of high debt was common across the Western world. In fact, as societies shifted from a regime of higher inflation/lower real interest rate to one of lower inflation/higher real interest rate, they experienced the accumulation of public debt due to higher interest payments (Masson and Mussa, 1998). Yet, the debt problem in Italy assumed a unique significance in relation to the dynamics of *partitocrazia*. To give a better sense of the issue, Italian public debt was sustained by a market for government securities that was the world's third-largest after its American and Japanese counterparts (Scobie et al., 1996, 75). What is more, according to the data for 1993, interest payments on the debt absorbed 22.6

per cent of government expenditure (IMF, 2003, 101).

It is in this context that proposals for reforms began to be discussed at the Treasury in collaboration with the Bank of Italy. In 1986, the Treasury Minister Giovanni Goria formed a technical committee under the direction of Director-General Mario Sarcinelli.¹³⁷ This committee ended its works in 1987. Successively, the new Treasury Minister Giuliano Amato established another committee in 1988, this time under the leadership of Luigi Spaventa.¹³⁸ Here, experts examined several aspects such as: the most appropriate policies of debt management; the functioning of the markets for government securities; and the linkages between debt and monetary policy (Ruffolo, 1988). Through their research and advising activities, they looked for all possible solutions to reduce the costs of debt service for the Italian government. Whilst doing so, they also became intolerant towards the political class and its inability to contain the deficit. As Sarcinelli explicitly declared in October 1990, “we issue a colossal amount of government debt which is practically unsustainable. [...] I have to tell everyone that the current situation is no longer feasible and we need constraints on our public finances” (Signoretti, 1990, my translation). At that time, Italy was about to start the EMU negotiations and Sarcinelli’s opinions were shared by the Treasury Minister Carli – who was appointed after Amato left the post in July 1989 – as well as the majority amongst those who took part in the intergovernmental conference.

These two committees were instrumental in building an environment for the management of debt which was more attuned to market-oriented principles. Over the course of the 1980s, the Treasury strived to minimise the costs of debt whilst controlling the risk related to interest-rate fluctuations as well as the one concerning debt refinancing. In order to achieve these objectives, it became crucial to extend the average life of debt and to spread the distribution of maturity more regularly

¹³⁷Sarcinelli was former deputy Director-General of Bank of Italy (1976-1981) and joined the Treasury in 1982. See http://www.cavaliereidellavoro.it/cavaliere.php?numero_brevetto=2321 [accessed on December 30, 2012]. The Sarcinelli committee included as advisers: Mario Arcelli, Corrado Conti, Felice Gianani, Francesco Giavazzi, Lucio Izzo, Mario Monti, Rainer Masera, Antonio Pedone, Paolo Ranuzzi and Luigi Spaventa. See Tesoro (1987).

¹³⁸Advisers to the committee were: Mario Arcelli, Francesco Giavazzi, Mario Monti, Antonio Pedone, Maria Teresa Salvemini, Giacomo Vaciago, Mario Sarcinelli, Rainer Masera and Pierluigi Ciocca. See Tesoro (1989). Spaventa was a professor of economics and Member of the Parliament (1976-1983); Minister of Budget and Economic Planning (1993-1994); President of CONSOB (1998-2003). See <http://storia.camera.it/deputato/luigi-spaventa-19340305> as well as <http://archivio.lavoce.info/lavocepuntoinfo/autori/pagina86.html> [both accessed on December 30, 2012].

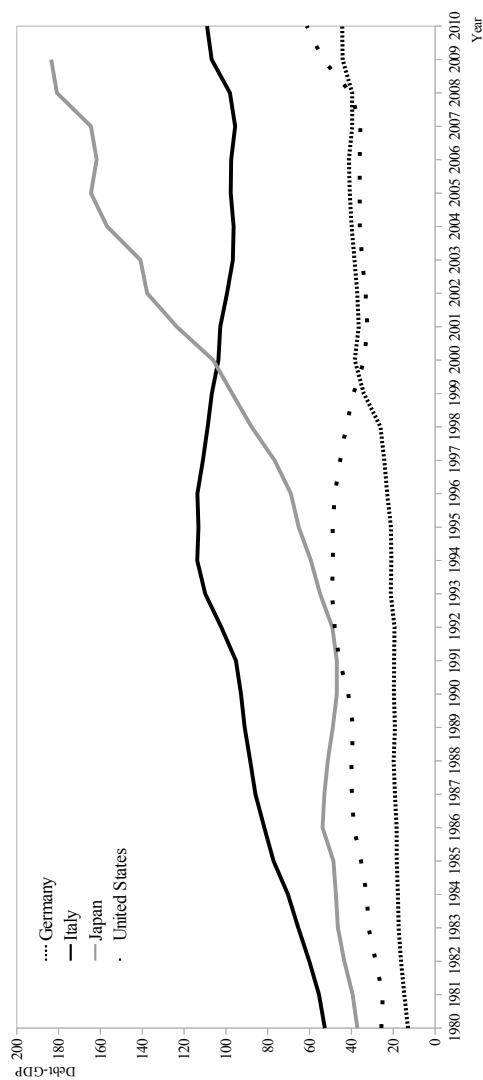


Figure 4.1: Debt-to-GDP ratio in Germany, Italy, Japan and United States, 1980-2010.

Source: own elaboration from data by Economic Co-operation and Development (Oecd); see http://stats.oecd.org/Index.aspx?datasetcode=gov_debt [accessed on December 30, 2012].

throughout the year (IMF, 2003, 101-102). As suggested by the Spaventa committee, the authorities decided that – besides diversifying the range of securities offered to investors – the quantity of fixed-rate long-term BTPs should have been increased relatively to the amount of floating-rate medium-term certificates (CCTs) and short-term bills (BOTs) in circulation.¹³⁹ The declining inflation rate would have favoured such a shift by persuading investors that it was no longer risky to hold long-term bonds. However, this strategy led to a segmentation in the structure of the Italian public debt. On the one hand, households kept investing in CCTs and BOTs as they had traditionally done since the late 1970s. They held these instruments until maturity. On the other hand, most part of BTPs ended up being bought primarily by large foreign investors who – far from holding these bonds to maturity – adopted them instead for their speculative and arbitrage activities. As a result, these mechanisms began to impose a certain degree of external discipline on the sovereign management of interest rates (De Cecco, 1994).

Besides opening up to global market dynamics, it was particularly the establishment of Mercato Telematico dei Titoli di Stato (MTS) that provided the major incentive to the introduction of market-based techniques in public-debt management.¹⁴⁰ The Italian government had traditionally relied on underwriting bank syndicates for the primary issuance of debt securities (Scobie et al., 1996, 76). The secondary market was instead based on interbank contracts amongst few insiders.¹⁴¹ In May 1988, once the Treasury launched MTS, this rather passive scenario began to change rapidly. In fact, whilst a greater use of auctions was made as the standard procedure for issuing debt instruments (IMF, 2003, 103), MTS provided instead a screen-based environment for the wholesale secondary trading of government bonds. Here, a system of primary dealers quoted bids and asks, creating a condition in which investors could easily divest their positions (IMF, 2003, 106). This facilitated the access of

¹³⁹BTP stands for Buono del tesoro poliennale; CCT is the acronym for Certificato di credito del tesoro; BOT stands for Buono ordinario del tesoro. See http://www.dt.tesoro.it/it/debito_pubblico/titoli_di_stato [accessed on December 30, 2012].

¹⁴⁰About the creation of MTS, cf. ministerial decree February 8, 1988. See Caputo Nasseti (2011, 292).

¹⁴¹These conditions were perfectly integrated with a scenario in which the authorities conducted monetary policy by manoeuvring banks' lending ceiling. Imposing a limit on the lending activities by banks – and in the presence of international capital controls – simply meant redirecting their deposit base towards government securities as the only investment choice available to them (Rondelli, 1994, 98). Although with increasing difficulties, this process guaranteed the necessary flow of funds towards the borrowing requirements of *partitocrazia*.

foreign actors to the secondary market for Italian bonds (Petrini, 1987). Hence, the Treasury had concretely switched to market-based practices of public-debt management by the early 1990s. This was done on the basis that “private-sector-type structures or procedures for managing public debt [...] [could have saved] some fractions of a per cent in debt costs” (Giovannini, 1997, 45). The government began to be seen as a market actor undertaking an *active management* of its debt. This entailed the development of benchmark portfolios in order to capture the optimal trade-off between the costs and risks of debt service (Cassard and Folkerts-Landau, 1997).

At this point, with the marketisation of public debt in full swing, the institutions and discourses of derivatives-based risk management emerged in Italy. Futures and options were deemed to make government bonds more attractive by providing hedging solutions to fixed-income investors (Repubblica, 1992). Besides this, more pragmatic opinions were instead daunted by the launch of BTP futures at the Paris MATIF and the London LIFFE.¹⁴² It seemed that foreign markets had gained a first-move advantage on a product which was Italian by definition. As the leading newspaper *La Repubblica* commented, “a market which is valued roughly sixty thousands billions lire per year [was] born in foreign land” (Petrini, 1991*c*, my translation). Thus, the process of learning by imitation gained momentum and the Treasury Minister Carli finally announced that futures were going to be launched in Italy by the first half of 1992 (Signoretti, 1991). In fact, the Mercato Italiano Futures (MIF) was established by ministerial decree on February 18, 1992 (Girino, 2010, 542). It became operative on September 11 of the same year (Repubblica, 1992). This market was an adjunct to the above-mentioned MTS and, for this reason, it was based on the very same electronic platform and organisational structure (Rondelli, 1994, 109-110). Cassa di Compensazione & Garanzia (CC&G) was established as the clearing house in charge of central counterparty functions in March 1992.¹⁴³ The first contracts traded at the MIF were futures on the 10-year and 5-year BTPs (Caputo Nasseti, 2011, 264-265).¹⁴⁴

¹⁴²BTP futures were introduced at the MATIF and LIFFE respectively on September 5 and 19, 1991 (Petrini, 1991*b*).

¹⁴³See <http://www.ccg.it/jportal/pcontroller/NavigatorHandler?nodo=20639> [accessed on December 30, 2012].

¹⁴⁴In 1994, options on BTP futures were introduced on a market segment known as Mercato Telematico delle Opzioni (MTO) (Repubblica, 1994*c*). By that time, exchange-traded derivatives

By the time MIF began its operations in September 1992, the domestic political-economic scenario had already begun to change dramatically. To begin with, Italy's destiny was now tied to the neoliberal dynamics of EMU and the construction of the single market. As already seen, these processes had considerably increased the agential power of technocrats vis-à-vis the old political-economic regime. Second, the system of *partitocrazia* approached its inexorable decline. In this context, technocrats captured the executive power and implemented their austerity measures in a systematic manner. More importantly, these actors moved their attention away from organised derivatives markets and unleashed instead their fight for Europe in the 'wild Wild West' of derivatives trading (Partnoy, 2009, 18): the over-the-counter markets.

4.2 Derivatives and the fight for Europe

Technocratic elites gained influence within state affairs since the 1980s. They gradually advanced practices that disturbed the reproduction of the status quo in Italian capitalism. Yet, these tactics were not sufficient to dismantle long-established power structures, both in their political and business dimension. For instance, early reforms – which were introduced in line with the single market – did not involve major changes in the country's financial system and corporate governance regulation. In this regard, the oligarchic structure of big business was largely unchallenged. Furthermore, for what concerns instead *partitocrazia* and the dissipation of public expenditure, this was certainly the primary vexation of technocrats who used the intergovernmental conference on EMU to impose mechanisms of external discipline on Italian public finance (Dyson and Featherstone, 1996). However, imposing a regime

in Italy had begun to transcend the dimension of government securities. In fact, the Consiglio di Borsa in Milan launched index futures and options respectively in 1994 and 1995 (Sunseri, 1994; BorsaItaliana, 2008, 34). As a result, the Italian Derivatives Market (Idem) came into being. Here, equity derivatives were adopted later (BorsaItaliana, 2008). After the privatisation of capital markets (BorsaItaliana, 1999), the newly privatised Borsa Italiana acquired MIF in May 1998 (BorsaItaliana, 1998). However, following the introduction of the euro, trading volume concentrated particularly on German bonds and MIF shut down in 2002 (Fiore, 2007, 99). At this point, Borsa Italiana had already expanded towards other products such as covered warrants and certificates (BorsaItaliana, 2008). Today, exchange-traded derivatives markets in Italy are organised around four segments: Idem; securitised derivatives exchange (SeDex); exchange-traded funds (ETFplus); Mercato Telematico delle Obbligazioni e dei Titoli di Stato (MOT) where ABSs are traded (BorsaItaliana, 2007).

of macroeconomic austerity could not have unravelled an entire political system. All these considerations point to one important fact: it was not the technocratic assault per se which brought the system of *partitocrazia* to a full collapse, but rather the judiciary investigation disclosing *Tangentopoli*.

The latter was the extensive system of kickbacks and illicit party funding which linked politics with the business world during the 1980s.¹⁴⁵ It all started on February 17, 1992 in Milan, when the police caught Mario Chiesa red-handed whilst accepting a bribe from the owner of a cleaning firm. Chiesa was the manager of a retirement home and an influential member of the Socialist Party. He let everything out and explained to prosecutors how the system of bribes he was involved in worked. As the magistrates began to uncover these schemes, they realised that Chiesa was not an isolated case. What Italy experienced in those years was instead an immense network of corruption which involved all the ruling parties – primarily, DC and PSI – together with their business clientele. As the news about the investigation spread in the media, the scandals spiralled amidst huge popular outrage. At a moment in which Italian politics had already reached a dead end, *Tangentopoli* represented the ‘emotional factor’ that ‘made a clean sweep’ of the entire political regime (Berselli, 2001, 7), its long-established practices of *partitocrazia* and most part of its business connections.¹⁴⁶

Hence, it was only once the bribery scandals exploded in 1992 that technocrats had the chance to capture the executive power and unleash their reforms in the name of Europe. How did these dynamics unfold? More importantly, how did they integrate derivatives as crucial practices of their strategies? Let us look first at the period 1992-1996. During this time, a series of technocratic governments – only partly interrupted by the brief Berlusconi administration – began the fight to conform

¹⁴⁵The following summary of the events is based on Ginsborg (2001, 179-186, 249-259).

¹⁴⁶About the crisis of Italian politics at the turn of the 1990s, see Berselli (2001) and Ginsborg (1996). According to Berselli (2001, 4), the DC-PSI alliance produced several structural problems such as the “unbalanced national budget, insufficient modernization, an aging institutional establishment, an increasingly wasteful welfare structure.” Ruling parties managed to hide these critical factors, but both external and internal phenomena turned against them by the early 1990s. First, the Soviet Union collapse removed the communist threat over which DC had built its own legitimacy. Second, the Northern League emerged as a secessionist political force and gained great consensus in the Italian Northern regions. Finally, Italians supported a referendum the aim of which was to transform the electoral system into one based on a majoritarian representation. Hence, at a moment in which Italian politics faced such critical conditions, *Tangentopoli* represented the missing element that demolished the entire system (Berselli, 2001, 7).

Italy with the Maastricht convergence criteria, whilst also implementing a substantial round of privatisation and banking reforms. In this period, the Treasury and the Bank of Italy used over-the-counter derivatives markets in order to manoeuvre interest-rate convergence between Italian BTPs and German bunds (Dunbar, 2000, 149-162). After this, the section moves on to examine the period 1996-1999. In these years, the Olive Tree coalition got to power and joined forces with the technocrats by strengthening their neoliberal strategies. This coalition reinforced the regime of austerity in public finance, launched a second round of privatisation and continued the battle for interest-rate convergence. Last but not least, the Olive Tree coalition arranged a unique currency swap which manipulated the budget deficit for the year 1997 (Piga, 2001, 122-129).

4.2.1 Capturing and insulating the executive

After the general election of April 1992, DC and PSI managed to form a government together with two long-time political partners, Partito Socialista Democratico Italiano (Psdi) and Partito Liberale Italiano (PLI). But, as the *Tangentopoli* investigation escalated, it involved more and more members of these ruling parties. For this reason, the President of the Republic Oscar Luigi Scalfaro chose the Socialist Giuliano Amato – whose reputation was still intact – as the new President of the Council of Ministers on June 28, 1992.¹⁴⁷ As soon as he entered the executive, Amato faced the events of the speculative attacks on the lira and its eventual devaluation outside the EMS in September 1992 (Eichengreen, 2000; Harmes, 2001). This crisis dealt a blow to Italy's ambition to participate in the EMU project. It encouraged the Parliament to delegate to the executive the power of introducing reforms in the areas of pensions, health, public sector employment and local finance. At the same time, the government undertook substantial cuts in public expenditure and signed a tripartite agreement with the trade unions (Sbragia, 2001, 90). The latter overhauled the system of wage indexation with the aim of containing inflation (Regini and Regalia, 1997, 213-214).

Amato eventually resigned in April 1993. Yet, in spite of this, his government marked a turning point in the decade. Public opinion perceived that Italy was a

¹⁴⁷About the Amato government, see <http://www.governo.it/Governo/Governi/amato1.html> [accessed on December 30, 2012].

country at risk due to a lack of convergence with the Maastricht criteria. This ‘lack of fit’ appeared as a threat of exclusion from the project of European integration (Sbragia, 2001, 83). For this reason, it justified the introduction of austerity measures and market-oriented reforms in the years to come. Few voices questioned this trend, most notably left-wing radical exponents who criticised EMU for being a project that was implemented to the detriment of social equality (Benedetto and Quaglia, 2007). However, these opinions came from a minority which was marginal in the political landscape. Hence, they were not given enough attention to. In other words, the public debate was insulated from any critical perspective on European integration. General consensus favoured Europe and there was only one direction to take: neoliberal austerity and market-oriented reforms.

By the time Amato stepped down, the investigation concerning *Tangentopoli* had already involved a large fraction of the political and business establishment, including top politicians and businessmen such as the Socialist leader Craxi, the chief executive of ENI Gabriele Cagliari and the entrepreneur Raul Gardini (Ferruzzi). In other words, the country’s traditional party system and its business linkages disintegrated. It is at this point that technocrats fully captured the executive and consolidated their agential power in the domestic scene. Indeed, instead of calling for early elections, President Scalfaro opted for establishing a technocratic government led by Ciampi. It was the first non-elected cabinet in the history of the Italian Republic.¹⁴⁸ Having just resigned from his governorship at the central bank, Ciampi vehemently reasserted the objective of fighting for Europe. He secured the agreement of July 1993 with the trade unions, continuing what Amato had already achieved in the realm of labour relations. This pact confirmed the abolition of wage indexation and established a clearly defined architecture for collective bargaining (Regini and Regalia, 1997, 214).

Furthermore, the Ciampi administration implemented important reforms in two realms. First, it gave a new impetus to the privatisation of the state-owned enterprise by establishing the technical committee which advised on the necessary operations.¹⁴⁹ This committee was led by Mario Draghi who had replaced Sarcinelli in the position of Director-General at the Treasury in February 1991 (Petrini, 1991a). In

¹⁴⁸About the Ciampi cabinet, see <http://www.governo.it/Governo/Governi/ciampi1.html> [accessed on December 30, 2012].

¹⁴⁹About the process of privatisation in Italy, see Goldstein (2003) and Tesoro (2001).

addition to this, it dismantled the Ministry for State Shareholdings and established the sinking fund where the privatisation revenues were to be deposited and used for purposes of public debt control.¹⁵⁰ Second, besides the events concerning the privatisation process, Ciampi ratified also the consolidated law on banking (*Testo Unico Bancario*, TUB), a fundamental reform which reintroduced universal banking in Italy.¹⁵¹ By transposing the European second banking coordination directive into Italian law, TUB gave foreign banks the right to operate in Italy through a single ‘passport’ obtained from the home-country authorities.¹⁵² The emergence of foreign actors – as well as the creation of big national banking groups through mergers and acquisitions – challenged the consolidated position of Mediobanca within the Northern industrial universe (Economist, 2000).

More importantly for the purposes of this thesis, it was during the last period of the Ciampi government that the Treasury developed an aggressive strategy aiming at the reduction of debt servicing which lasted until the 1997.¹⁵³ This manoeuvre was undertaken on the over-the-counter derivatives markets and involved the most famous and highly leveraged hedge fund Long-Term Capital Management. In 1994, Alberto Giovannini – co-chairman of the council of experts who directly answered to the Director-General Draghi – was responsible for the coordination of foreign debt at the Italian Treasury.¹⁵⁴ Although Giovannini claimed that his role was marginal, it is clear that somebody gave LTCM – and few other arbitrage desks – privileged information.¹⁵⁵ The objective was to encourage these powerful financial actors to

¹⁵⁰Cf. respectively presidential decree no. 174, June 5, 1993; law no. 432, October 27, 1993.

¹⁵¹Cf. law decree no. 385, September 1, 1993 and successive updates.

¹⁵²Cf. Second Council Directive 89/646/EEC, December 15, 1989 at <http://eur-lex.europa.eu> [accessed on December 30, 2012].

¹⁵³Piero Barucci replaced Carli as Treasury Minister in June 1992. He remained in his post until May 1994. Barucci was former president of the Italian banking association (ABI). See <http://www.agcm.it/organizzazione/105.html> [accessed on December 30, 2012].

¹⁵⁴Mario Sarcinelli established the council of experts in 1985 as a research department advising the Director-General. Experts were appointed for four years on a renewable basis (Quaglia, 2002, 93-95). When Draghi replaced Sarcinelli, he brought in a group of young and influential academics: Francesco Giavazzi, Vittorio Grilli and the above-mentioned Giovannini (Repubblica, 1994a). Both Giovannini and Giavazzi left the council in August 1994 (Repubblica, 1994b). Giovannini began working for LTCM in 1995. See <http://www.technologyreview.com/article/424397/alberto-giovannini-phd-84/> [accessed on December 30, 2012]. Grilli became Director-General for Economic Analysis and Privatization (1994-2000); regent Director-General for Public Debt and State Treasury (1996-1997); Italy’s State Accountant General (2002-2005); Director-General of the Treasury (2005-2011); incumbent Minister of Economy and Finance (July 2012). See <http://www.tesoro.it/en/ministero/ministro.html> [accessed on December 30, 2012].

¹⁵⁵According to Dunbar (2000, 153), this information came from the Bank of Italy.

buy huge amounts of Italian bonds, therefore inflating bond prices and pushing down interest rates accordingly. This strategy dealt a blow to domestic banks which up until then had bought bonds at low prices and earned high interests. In return for this favour, the Treasury and particularly the Bank of Italy established a cosy relationship with LTCM by investing \$100 million via the Italian foreign-exchange office in October 1994 (Dunbar, 2000, 152-154).¹⁵⁶ As Frank Partnoy (2009, 252-253) points out:

Much of LTCM's activity was in Italy, where it had extraordinary connections. Not only did LTCM employ the former Italian Treasury official responsible for debt management [Giovannini], but the Bank of Italy [...] invested \$100 million with LTCM. [...] It was no coincidence, then, that in one trade LTCM purchased an estimated \$50 billion of Italian government bonds. [...] LTCM owned 25 percent of one segment of the Italian government-bond market. In other trades, LTCM benefited from an Italian tax loophole for foreign investors, and from the prospect of Italy's entry into the European monetary system, about which it had very good information.

Derivatives entered the picture through the arbitrage strategies of LTCM and the other actors following its steps. For instance, as Dunbar (2000, 155-156) shows, one of the profitable trades that Victor Haghani – head of LTCM's office in London – and his team were able to implement was a typical swap-spread arbitrage.¹⁵⁷ The opportunity for this operation was signalled by the *swap spread*, that is the difference between the fixed-rate leg of a swap and the yield on a government bond of the same maturity. In 1994, receiving Italian lire swaps-rate payments was considered less risky than buying Italy's government bonds and receiving their coupons. In graphic terms, the swaps yield curve stood below the one for the Italian BTPs. This was due to the fact that the swap rate fell in the expectation of Italy's participation in the EMU. Yet, investors were still wary of Italian government bonds. Hence, they required a higher interest rate. In this context, Haghani's trade would work in the following way. His team would buy BTPs on the market for repurchase agreements

¹⁵⁶Berlusconi got to power in May 1994 and remained until January 1995. Although his cabinet was less eager to fight for Europe, this aspect did not affect the policies concerning public debt.

¹⁵⁷For a full description of Haghani's strategies, see Dunbar (2000, 156-162). For a study about LTCM and arbitrage, see also MacKenzie (2003).

(repo) through Morgan Stanley.¹⁵⁸ In so doing, they would receive fixed-rate coupons from their BTP position whilst paying lira LIBOR to Morgan Stanley. At this point, traders would hedge their floating LIBOR payment to Morgan Stanley through a floating-to-fixed interest rate swap. In other words, they would enter into a swap with another bank such as Deutsche Bank where the latter would pay lira LIBOR to LTCM, therefore cancelling out the LIBOR payment to Morgan Stanley. Haghani's team would instead pay the fixed swap rate which, as mentioned above, was lower than the BTP's fixed rate. This arbitrage strategy would allow LTCM to profit from the difference between the BTP and the swap rates until the two would converge. This and other types of trades by LTCM and other arbitrage desks resulted in a huge amount of capital flowing into the Italian bond market. These tactics were crucial to support Italy qualifying for EMU (MacKenzie, 2003, 357).

Whilst arbitrageurs inflated prices and caused great losses to the Italian banks (Dunbar, 2000, 159), the course of events continued on the political arena. The coalition led by the media entrepreneur Silvio Berlusconi won the national elections in May 1994.¹⁵⁹ His government was a centre-right coalition which included Berlusconi's own party (Forza Italia) together with former DC members, the neo-fascist National Alliance (Alleanza Nazionale, AN) and the Northern League (Lega Nord). In this regard, the Berlusconi administration was rather hesitant towards Europe (Ginsborg, 2001, 297). However, as a sign of continuity with the former technocratic government, Lamberto Dini was chosen as the unelected Treasury Minister.¹⁶⁰

In line with this continuum, the so-called 'privatisation' law was enacted during the Berlusconi's government.¹⁶¹ This law introduced the procedures and rules for the sale of state shareholdings, a dimension that had also a profound impact on the overall transformation of the corporate governance regime (see below). Under this regulatory framework, the Treasury reinforced the process of privatisation and generated a total return of over €90 billion by the year 2000 (Amatori and

¹⁵⁸The market for repurchase agreements – or repo market – is a money market where actors raise short-term capital. A repo involves a dealer selling bonds to investors on an overnight basis and then buying them back at a slightly higher price. Vice versa, for the party who buys the securities and agrees to sell them back, the practice is called reverse repo. See Choudhry (2011).

¹⁵⁹About the Berlusconi's cabinet, see <http://www.governo.it/Governo/Governi/berlusconi1.html> [accessed on December 30, 2012]. About the rise of Berlusconi, see Seisselberge (1996).

¹⁶⁰Dini was a former Director-General at the Bank of Italy (1979-1994). See <http://www.repubblica.it/online/politica/dini/dini/dini.html> [accessed on December 30, 2012].

¹⁶¹Cf. law no. 474, July 30, 1994.

Colli, 2001, 26). In the next years, particularly after the centre-left coalition got to power in 1996, the privatisation law served two objectives. First, it dismantled the institutional basis over which political parties established their relations of mutual reproduction with public managers. Second, privatisation increased the stock-market capitalisation through the IPOs of newly privatised companies, an aspect which encouraged the creation of shareholder-friendly rules undermining the power of business oligarchies (McCann, 2000).

Berlusconi lasted only until January 1995. By the time he left Palazzo Chigi (the executive's office), the traditional party system had entirely collapsed. PSI dissolved on November 12, 1994. The majority of ex-PSI members ended up scattered across the entire political spectrum. DC had already separated during the Ciampi administration (January 16, 1994), splitting in three different formations which largely reflected its old factions: the Italian Popular Party (Partito Popolare Italiano, PPI) at the centre; Christian Democratic Centre (Centro Cristiano Democratico, CCD) to the right; Social Christians (Cristiano Sociali, CS) to the left. Finally, PCI had dismembered on February 3, 1991. Most part of its members joined the newly founded Left Democratic Party (Partito Democratico della Sinistra, PDS). Radical left exponents established instead the Party of Communist Refoundation (Rifondazione).¹⁶² After Berlusconi resigned, President Scalfaro refused again to call for new elections and chose Dini as the new President of the Council of Ministers in January 1995. This administration included all unelected technocrats with Dini assuming also the position of Treasury Minister.¹⁶³ This transitional government overhauled the pension system and implemented drastic cuts in public expenditure (Sbragia, 2001, 93). Eventually, the national elections of April 1996 brought to power the centre-left coalition of the Olive Tree (L'Ulivo) under the leadership of Prodi.

4.2.2 The Olive Tree coalition: engineering 'a trick or two'

This section has thus far shown how technocrats captured the executive and asserted the objective of fighting for Europe amidst the general consensus of Italian elites and also the wider public. In so doing, these actors introduced austerity measures in

¹⁶²About the transition from the 'old' to the 'new' party system in Italy during the 1990s, see Gundle and Parker (1996).

¹⁶³About the Dini government, see <http://www.governo.it/Governo/Governi/dini1.html> [accessed on December 30, 2012].

public finance, initiated the privatisation of the state-owned sector and implemented a far-reaching banking reform. More importantly for what concerns the aim of this thesis, technocrats began making use of the available technology on the over-the-counter derivatives markets. They directed their efforts towards breaking the vicious cycle of low-price/high-interest bonds. They thought that “life would be much better if Italy could get a high price for its bonds and pay a low rate of interest” (Dunbar, 2000, 152). However, in spite of all these efforts, Italy was still far from meeting the Maastricht criteria when the Olive Tree won the elections in 1996. The deficit-to-GDP ratio was 6.7 per cent, whilst the level of debt to GDP was 123.8 per cent. The level of inflation was 3.9 per cent, that is 1.3 per cent higher than the average level of the three ‘best performing’ EU countries (Ginsborg, 2001, 304). Interest rates in Italy were considerably higher than in Germany, whereas the lira floated outside the EMS widely until November 1996, when it entered the system again (Quaglia, 2004, 1104). Furthermore, important reforms had been implemented during the previous years in line with the construction of the single market – most notably, the liberalisation of capital movements and the privatisation of the state-owned sector. Yet, this neoliberal re-regulation did not challenge business oligarchies.

Taking into account these aspects, it is fair to say that technocratic governments laid the groundwork for the modernisation of Italian capitalism. But, it was only once Prodi got to power that a neoliberal reformist coalition came into being and reinforced the initiative of rendering Italy a normal country in the name of Europe. Let us focus first on the efforts to join EMU in 1999. After this, the analysis looks at the unique currency-swap transaction put in place to window-dress the budget deficit. The next section (4.3) examines instead the reforms of corporate governance and their impact on business oligarchic structures.

4.2.2.1 The great battle for convergence

The Olive Tree coalition was formed when the PDS-leader Massimo D’Alema opened up to part of the Catholic forces after Prodi announced his intention of running against Berlusconi in the 1996 elections (Ginsborg, 2001, 300). This move by the PDS leader signalled a profound transformation in the Italian left which – after the collapse of the Soviet Union and the dissolution of PCI – abandoned its Gramscian legacy in favour of an ill-defined liberal socialism. As Ilaria Favretto (2002, 403)

shows, PDS portrayed itself as the only political force which was capable of solving the long-lasting disparities in Italian capitalism. It aimed at doing so by dismantling the old regime and constructing instead a modern, normalised, Europeanised market democracy. However, apart from few of these vague slogans, former communist politicians ultimately embraced the neoliberal tenets which technocratic elites had espoused until then (Ginsborg, 2001, 303). Hence, technocrats showed the newly elected Olive Tree coalition the areas where to intervene in order to normalise Italy. Crucial in this regard was the appointment of Ciampi at the Treasury – again, as an unelected policy-maker – who immediately strengthened the power of his Ministry through a merger with the Ministry of Budget and Economic Planning.¹⁶⁴

With Ciampi in this position, the Prodi administration was very determined to join EMU. However, as mentioned above, the macroeconomic scenario in 1996 was far from being in line with such parameters. In June 1996, the government initially submitted an economic and financial planning document which would have brought the deficit down to 4.4 per cent in 1997 and, finally, 3 per cent only in 1998. In other words, Italy would have been one year late on the reference period agreed for EMU membership. The document nonetheless left open the possibility for further tightening manoeuvres in the late 1996. Several explanations could be given for why the government prepared this initial plan. Suffice it to say that although the majority within the cabinet was fully committed to EMU membership, many political-economic forces were conscious that reaching a deficit of 3 per cent was not feasible. It was hoped that other member states – primarily, France and Germany – would have interpreted the imperative of meeting the criteria with some margins of flexibility. In the end, the very same Prodi admitted that not joining EMU on time was hardly a tragedy (Quaglia, 2002, 256-258).

Yet, this attitude changed dramatically after Prodi met with the Spanish prime minister José María Aznar in mid-September 1996. Here, Prodi put forward the possibility of interpreting the Maastricht criteria more flexibly than what stated on the Treaty. But, Aznar was not “interested in holding hands” with Italy (White and Burns, 1996). Spain was going to join EMU on time and by meeting the criteria in

¹⁶⁴As a result of the merger, the economic ministries were now only two: the newly established Ministry of Treasury, Budget and Economic Planning; the Ministry of Finance. About the Prodi administration, see <http://www.governo.it/Governo/Governi/prodi1.html> [accessed on December 30, 2012].

full. At this point, Prodi realised that Italy was practically isolated at the European level (Battocchi, 2011). Both the German Chancellor Helmut Kohl and the French President Jacques Chirac did not intend to postpone the beginning of EMU after 1999. Furthermore, they rejected the possibility that the convergence criteria could be interpreted loosely. It was a logic reaction from two governments which had been very sceptical about Italy joining EMU from the start (Quaglia, 2002, 249-253). Now, Aznar's bold statement eliminated also the chance for building a common Southern-European front to pressure in favour of loosening up the criteria. Considering this external scepticism, there was no other option but showing that Italy was 'fit for Europe' on the basis of sound macroeconomic data.

For this reason, Prodi turned to the domestic scenario and depicted EMU as an issue of national interest. Being left out of Europe was a threat which justified drastic economic measures. It was a test for Italy's patriotism in a situation of emergency for the entire nation (Ginsborg, 2001, 305-306).¹⁶⁵ Thus, the government presented a budget law in October 1996 which aimed at achieving the target of 3 per cent in 1997. This manoeuvre involved drastic spending cuts and increased taxation, including a one-off 'tax for Europe' (Radaelli, 2002, 223-224). At the same time, Ciampi engineered the re-entry of the lira in the EMS on November 24, 1996. The new parity was overvalued mostly in line with what suggested by the Bundesbank (Quaglia, 2002, 247-248).¹⁶⁶

The decision to join EMU on time caused intense controversy. Whereas centre-left politicians, trade union leaders and even the radical left exponents went along with the plan, centre-right forces strongly opposed the government and organised a major rally in the late November 1996. Business elites – most notably, Cesare Romiti of FIAT – also demonstrated scepticism about joining EMU in 1999 (Ginsborg, 2001, 306-307). Even within the community of experts and the very same policy-makers, many voices argued that the country was not ready to join EMU yet. In particular, the new Governor of Bank of Italy Antonio Fazio was rather pessimistic about the project, an aspect which signalled a reorientation in the central bank's attitude

¹⁶⁵The image of a threat to the nation seemed even more real due to the secessionist propaganda of the Northern League (Ginsborg, 2001, 305-306).

¹⁶⁶Technically, Italy was already precluded from joining EMU in 1999. Indeed, the country had been outside the normal fluctuation bands of the EMS since September 1992. As noted by the *Financial Times*, "[u]nder plausible interpretations, Italy can no longer meet this criterion. Ever optimistic, Italy hopes for a fudge" (FT, 1996).

towards Europe (Quaglia, 2002, 271-272). In the end, the budget law was passed on December 23.¹⁶⁷

Domestic opposition was a rather minor concern compared to what the Prodi administration had to face abroad. Germany and France were, to say the least, intolerant about Italy joining EMU. Germany showed a clear preference for a ‘two-tier’ Europe in which a core of member states could launch the single currency. Successively, other countries such as Italy, Spain or Portugal could have joined too once they had put their houses in order (Quaglia, 2002, 250). This strategy became even more clear in mid-October 1996, once Hans Tietmeyer – head of the Bundesbank – warned that “member countries [should] not just reach the criteria through a breathless short-term effort with one-off results quickly cobbled together” (FT, 1996).

The most interesting aspect of this attack by foreign governments on Italy was how it launched powerful signals to financial markets where, as already seen, arbitrageurs were betting on Italy and the German bonds to converge. It is fair to say that financial markets represented the major ground where Italy fought its right to join EMU in 1999. In fact, as Lucia Quaglia (2002, 66) explains, “[t]he key element in the Italian fiscal adjustment [...] was the reduction of the interest payments on the Italian public debt.” In other words, reducing the amount of money that Italy had to pay to bondholders would have allowed the Treasury to deduct from the total deficit a large sum of money – possibly achieving a primary surplus. So crucial was this element that a convergence between Italian and German interest rates could have cut down the deficit “by up to 1 per cent of GDP without the Italian government lifting a finger” (Barber, 1997*b*). Needless to say that this strategy was a top priority for the Treasury Minister Ciampi since its appointment in April 1996. Indeed, by the end of the same year, the Treasury had already managed to reduce the spread between Italian and German bonds substantially. According to the mainstream rhetoric, Italy was being rewarded for its ‘credibility’ in implementing macroeconomic discipline (Quaglia, 2002, 253).

Considering how rapidly the spread was shrinking, it became imperative for those opposing Italy’s participation in the EMU to change the course of financial market expectations. The most emblematic moment was the media ‘plot’ against

¹⁶⁷Cf. law no. 663, December 23, 1996.

Italy which was launched through the pages of the *Financial Times* on February 5, 1997. According to the article, Italy was made an offer that postponed its entry to EMU until 2000 or 2001. In other words, Rome would have missed the ‘first wave’. However, it would have nonetheless joined the single currency before the actual adoption of euro notes and coins on January 1, 2002. In this regard, “[t]he trick [was] to allow the Germans to say that Italy is out of the first wave... while making the Italians feel comfortable enough to say they are more or less in” (Barber, 1997*a*). Whether the plot was true or not, financial markets received the message. As a result, the spread widened between January and March 1997 (Quaglia, 2002, 254).

As luck would have it, whilst the debate focused on Italy as a risk to the stability of the euro, events both in Bonn and Paris turned sour. In Germany, unemployment figures soared and cast doubts about the stability of the major economy in Europe (Barber and Norman, 1997). In this situation, it was difficult for German elites to oppose Italy’s participation on the basis of a lack of convergence with the Maastricht criteria. In France, on the contrary, the Socialist Lionel Jospin became the new prime minister in June 1997. Jospin opposed any possibility that the Bundesbank could cast its hegemonic projections over European monetary affairs. In addition to this, he also feared that Italy would have gained in terms of export-price competitiveness by staying outside the Euro area. Finally, his government had growing problems in meeting the deficit parameters too (Quaglia, 2002, 252-253). These three factors converged in making Jospin a strong supporter of Italy’s participation in the EMU. In sum, the events along the Franco-German axis changed Italy’s position in Europe for the better. The idea of a hard core of member states leading the first entry to EMU was waning.

In the mid-1997, financial markets began supporting the spread convergence between Italian and German bonds again. Whilst in April 1995, the 10-year-old spread was as high as 600 basis points, it had fallen to merely 97 basis points by July 1997 (Guha and Luce, 1997). Arbitrageurs became confident about Italy’s participation in the EMU (Quaglia, 2002, 255). At the same time, Italian leaders were also receiving supportive signs from other member states. For instance, the Austrian Minister of Finance Rudolf Edlinger stated that Italy had designed “a very creditable consolidation and convergence programme” and that he “would not

be happy” if EMU had started without Italy (Hall, 1997). This support to the Italian government became even stronger once the Prodi administration proposed to attack the pension system in October 1997. The party Rifondazione opposed the cuts and overthrew the government. Although a compromise was eventually found and Prodi returned to power, the episode spurred an atmosphere of great hostility by the wider public towards the radical left. As Sbragia (2001, 94) pointed out, the episode showed “how deep was the desire to do what was necessary to enter the Eurozone.” Most tellingly, Prodi’s brief crisis had no major negative impact on financial markets. Thus, the Parliament approved the 1998 budget law including all the drastic reforms which had been initially proposed.¹⁶⁸

By February 1998, when Ciampi visited Germany, political-economic and financial elites applauded Italy’s policy achievements and welcomed him warmly (Schmid, 1998). It was the sign that relations between the two governments were smooth and Italy deserved a place in Europe. In this friendly atmosphere, three convergence reports were released respectively by the European Commission, the European Monetary Institute (EMI) – the predecessor of the European Central Bank (ECB) – and the Bundesbank in March 1998. It was recommended that eleven countries should have adopted the euro currency as of 1999. Italy was part of this group regardless of the high level of public debt (Barber, Fisher and Munchau, 1998). Prodi and Ciampi could finally sigh with relief. According to the EMI report (1998), Italy’s macroeconomic figures for 1997 were: inflation (1.9%); interest rate (6.9%); budget deficit (2.7% of GDP); public debt (121.6% of GDP). On May 3, 1998, the European Council, held in Brussels, made this decision official (Quaglia, 2002, 240).

4.2.2.2 LIBOR minus 16.77%: an unusual currency swap

As shown above, France and Germany opposed the Italian centre-left government in its attempt to join EMU against all odds. In such a hostile environment, Prodi expressed the following thoughts during an interview with the *Financial Times* in October 1996 (Graham, 1996):

If others carry out window-dressing we can do the same... If no-one does then we don’t... If the French get away with it, then we can show them a trick or two as well.

¹⁶⁸Cf. law no. 449, December 27, 1997.

Prodi referred to the French plan of transferring 37.5 billion francs from France Telecom's pension funds to the Treasury in order to window-dress the budget deficit in line with the Maastricht convergence criteria (Friedman, 1996). Prodi did not explain what his 'trick or two' implied. However, it was clear that, as the fight for Europe intensified, the Italian government was ready to deploy all its available resources in order to participate in the launch of the single currency from the start. Let us remember again that this was a very crucial point in the political-economic strategies set in motion by the neoliberal reformists. For them, Italy's struggle to become a normal country passed through Europe inevitably. Missing EMU in 1999 entailed the great danger that the 'first joiners' would have eventually marginalised the 'latecomers'. In other words, Italy would have been relegated to the lower level of a two-speed Europe – a situation which, according to Ciampi, could have easily become 'chronic' (Quaglia, 2002, 260).

It is in this scenario of disquietude about the threat of being left out that the Prodi administration adopted derivatives practices in the most controversial manner. Here, a rather simple currency swap was twisted into a device that window-dressed the decisive budget deficit for the year 1997. It is not clear to which extent such artifice helped Italy's macroeconomic data fit with the convergence criteria (Piga, 2001, 128). Yet, for the purposes of this thesis, the episode clearly demonstrates how Italian neoliberal reformists adopted these instruments as crucial to their highly politicised struggle. Following the insightful research by Gustavo Piga (2001, 122-129), this is how the story went.¹⁶⁹

¹⁶⁹Unless otherwise referenced, the following analysis is based on Piga (2001, 122-129). Piga's work is the most accurate account of the use of swaps in public-debt management. His research – based on official documents and interviews – is particularly impressive considering that the subject matter is hardly open to public accountability. Due to the sensitivity of the issue, Piga kept the country's and the financial counterpart's identities confidential. He opted instead for the hypothetical 'country M' and 'counterpart N' – a large derivatives market maker. However, one year after Piga's research was published, Ben Steil (2002) – the senior fellow at the Council on Foreign Relations who wrote the foreword to Piga's report – revealed that country M was Italy. What is more, the details of the yen-denominated bond issued by 'country M' – as reported by Piga – are consistent with the bond issuance made by Italy in 1995 (Repubblica, 1995). For what concerns the identity of the counterpart, ZeroHedge (2010) believed it was Goldman Sachs. Yet, the majority of sources referred instead to J.P. Morgan (Alloway, 2010). In the absence of concrete evidence, this thesis avoids directing the attention to either Goldman Sachs or J.P. Morgan. Hence, it simply uses the term 'counterpart'.

In early June 1995, Italy borrowed by issuing a 3-year and 3-month foreign currency bond which was denominated in yen.¹⁷⁰ The bond's par value was of ¥200 billion, its yearly coupon was 2.3% and maturity was set for September 25, 1998 (Repubblica, 1995). What is more, the bond was sold 'at par', therefore ¥200 billion. The exchange rate on the day in which the bond was issued was 193.44 Italian lire for 1 yen. The choice of issuing a foreign currency bond was justified by the fact that domestic interest rates for this maturity were higher than their Japanese equivalent. However, in spite of its convenience in terms of interest rate differentials, the bond presented the risk related to the exchange rate between yen and lira. As it is clear, an appreciation of the yen meant that the Italian Treasury would have incurred a loss in its yearly payments of the yen-denominated coupons and the final redemption of the par value in 1998. Luckily, by the late 1996, the yen had experienced a considerable depreciation against the lira. At that time, it was possible to buy 1 yen for 134.1 lire. But, despite this favourable depreciation, the Italian Treasury was still exposed to the exchange-rate risk in the remaining period until the maturity of September 25, 1998. It is at this point that active debt management through derivatives entered the story in a rather unconventional manner.¹⁷¹

Instead of using a normal currency swaps transaction to hedge the risk of the yen appreciating against the lira, the Italian Treasury designed an unusual strategy through which it managed to lower interest expenditure in 1997 and 1998, although increasing it from 1998 onwards.¹⁷² Simply put, the Treasury shot itself in the foot to join Europe! What does this scheme entail?

As Piga (2001, 126-129) shows, Italy entered into a currency swap with its counterpart in December 1996. The swap matured on September 25, 1998, that is the

¹⁷⁰The bond was the first of a three-tranche *mega emissione* of ¥550 billion. The maturity of the other two tranches were June 8, 2005 and June 8, 2015 (Repubblica, 1995).

¹⁷¹At the end of 1996, the Prodi administration had been in power for seven months. As already mentioned, Ciampi was Minister of Treasury, whilst Draghi was still the Treasury Director-General (he remained in that position until 2001). Under the direction of Draghi, Vittorio Grilli was head of the Treasury's directorate in charge of public-debt management (1996-1997). Successively, Vincenzo la Via replaced Grilli in 1997 and remained in charge of the directorate until 2000. La Via was financial director at the World Bank (1995-2012). He is the current Director-General of the Treasury since March 2012. See http://www.dt.tesoro.it/en/dipartimento/Biografia_laVia.html [accessed on December 30, 2012].

¹⁷²Piga (2001, 123, 147) provides striking evidence of such scheme through the copy of a swap undertaken by 'country M' and given to the scholar by a public officer. For what concerns the issue of how swaps transactions affects interest expenditure – and the budget deficit accordingly – see Piga (2001, chapter 3). This was possible under the European System of Accounts (ESA 95).

same date as the yen-denominated bond. Here, the financial intermediary paid 2.3% yearly fixed rate on a notional principal amount of ¥200 billion to the Italian treasury as well as the entire notional (again ¥200 billion) at the expiration of the contract. In so doing, the Treasury was perfectly hedged against the exchange-rate risk of its yen-denominated bond. So far, the contract included no irregular detail. The crucial element emerged in the yen-to-lira exchange rate at which the Italian Treasury had to return the notional principal amount of ¥200 billion. This was not 134.1 lire per 1 yen – that is the prevailing rate on the day the swap was agreed. On the contrary, the exchange rate was 193.44 lire per yen. This implied that the Treasury had to pay a much larger sum than what it would have done according to standard practices. The surprise did not end here. Every six months, Italy had to pay a rather singular interest rate of LIBOR minus 16.77% on the the lira-denominated notional amount of ¥200 billion times the off-market exchange rate of 193.44 lire per 1 yen. In other words, LIBOR minus 16.77% was a negative interest rate that allowed Italy to receive interest payments on both legs of the swap – taking into account the above-mentioned fixed 2.3% paid by the intermediary – until maturity.

To sum up, Italy promised to pay the financial intermediary a much bigger amount of lire due to the higher exchange rate of 193.44 lire per 1 yen. The intermediary paid Italy instead in four semi-annual instalments the very unusual LIBOR minus 1,677 basis points. On the basis of such evidence, Piga (2001, 128) concludes that:

[d]e facto, the sovereign borrower received four loans from counterpart N, every six months from 1997 to 1998. These loans were paid back at maturity in 1998 by disbursing a greater amount than would have been disbursed had the currency swap been constructed in a standard way. These four loans from counterpart N should have simply been considered as an increase in the public debt of country M, as standard international accounting practice requires for all loans a sovereign borrower receives [...] Was it? We strongly doubt it. Otherwise, why enter into such a complicated transaction in the first place? It is more likely that these four payments by counterpart N were used (against accepted accrual principles) to reduce interest expenditure in 1997 and 1998.

As already anticipated, it is not entirely clear how much this currency swap affected the budget deficit in 1997. It is obvious that the largest contribution to reducing the deficit was due to cuts in public expenditure and the convergence of the interest-rate spread between Italian and German bonds. However, according to Piga (2001, 128), ten transactions like the one reported above could have easily saved 0.2% at a time when the deficit-to-GDP forecast for the year 1997 was near 3%. To put it differently, such a saving of 0.2% would have allowed Italy to respect the EMU criteria.

4.3 Derivatives and corporate control

Thus far, this chapter has explored the unique modalities through which neoliberal reformists adopted derivatives in their crucial battle for conforming Italy with the Maastricht parameters. However, normalising public finance was only one side of the story. In addition to this, as already mentioned, reformists attempted also to challenge the oligarchic structure of Italian business. They did so by pushing for a comprehensive modernisation of Italian finance in line with the ideology of shareholder value. In this regard, it is possible to appreciate how the construction of a new corporate governance regime did not simply constrain corporate oligarchies. It also opened up opportunities for them to use derivatives in a tactical sense, manipulating the very same restrictions they were initially exposed to (Knafo, 2010, 503). Let us look first at the major changes in the corporate governance system as implemented by the Olive Tree coalition. After this, the study presents the case of FIAT and how the Agnellis deployed equity swaps to circumvent regulation and to consolidate the ownership over their business empire.

4.3.1 The shareholder-oriented transformation of corporate governance

Whilst stabilising the country's macroeconomic figures, the Olive Tree coalition implemented also another related project: the shareholder-oriented transformation of Italian finance. This process entailed constructing a regime of corporate governance which favoured the dispersion of ownership as well as the development of a liquid and efficient stock market. In other words, this strategy was coherent with the objective

of diluting the long-lasting oligarchic nature of Italian business in the attempt to render it more reactive to global market inputs and innovation. As the PDS-leader D'Alema explained, "we still have not done enough to create a proper financial market [...] We do not have guarantees for small shareholders, no rules for public companies" (Betts and Blitz, 1997).

The ideology of shareholder value originated in the historical evolution of American corporate capitalism, particularly once the latter fully unleashed the dynamics of financialisation after the 1970s crisis.¹⁷³ At its core stands a large and transparent stock market which functions as a source of business investment and corporate control for public companies. In a given company, dispersed and legally protected shareholders are the ultimate owners.¹⁷⁴ These actors delegate to the board of directors the task of monitoring the managers who are in charge of directing the company's day-to-day activities – e.g. investment, production, pricing, marketing and so on. In other words, managers are accountable to the board of directors and, ultimately, to the shareholders who have the voting power to select the board. The crucial point of this shareholder-oriented regime of corporate governance is the following: once the management fails to deliver profits and dividends, shareholders exercise their power at the general meeting and vote for a new board of directors and management. However, in reality, shareholders are too fragmented to exercise this control vis-à-vis the management and the passive board of directors. In this case, the market for corporate control enters the picture. Shareholders could show their dissatisfaction by selling the company's shares and, in turn, depressing the share price accordingly. At this point, the company turns into an attractive target for takeover strategies (Clarke, 2007, 130-131). The potential bidders buy up shares of the target company in order to take control of the board and replace the top management. In this sense, the market for corporate control disciplines the managers by pushing them to maximise shareholder value, otherwise they would succumb to hostile takeovers.

Once applied to Italy, this simple story concerning shareholder value promised

¹⁷³Unless otherwise referenced, the following brief analysis concerning shareholder value is based on Lazonick and O'Sullivan (2000).

¹⁷⁴In reality, the majority of shares are not properly dispersed, but owned by large institutional investors such as pension funds, mutual funds, hedge funds and insurance companies. Institutional investors represented a powerful force behind the emergence of shareholder value since the 1970s (Lazonick and O'Sullivan, 2000, 16).

a profound impact on the national business establishment. To be exact, as chapter three has shown, the historical rationale of Italian capitalism was rather different than the Anglo-American experience. In Italy, strong blockholders – such as the oligarchs and the state – influenced the activities of collusive managers against the interests of unprotected minority shareholders. In other words, whilst the major concern for shareholders in the Anglo-American system of corporate governance was the abuse of power by top managers, in Italy the key concern was instead the abuse of power by the blockholders (Melis, 2000, 354). Yet, as Dermot McCann (2000, 49-50) clearly explains:

[a] properly functioning capital market with strong institutional investors would ensure a greater equality of rights between shareholders, thus undermining the capacity of [blockholders] to gain a dominant control of firms despite possessing only minority holdings. The marginalization of cross-shareholding alliances would greatly increase the feasibility of successful takeover bids and thus intensify the pressure on management to deliver higher profitability and larger dividends [...] [T]his would serve to enhance economic efficiency and contribute to a growing meritocracy of ownership and control.

Liberal intellectuals had for a long time advanced the importance of reforming the Italian company law in order to prevent the formation of blockholders (Marchetti, 2001). Yet, in spite of these influential opinions, it was particularly during the 1990s that the political-economic and cultural climate turned conducive to introducing the institutions and discourses of shareholder value. In 1991, the Parliament passed the law which reformed stock-market regulation as well as a new regulation concerning insider trading.¹⁷⁵ Furthermore, a law on takeover bids was also passed in 1992.¹⁷⁶ Finally, in the same year, the Bank of Italy sponsored a research project which analysed corporate governance in Italy and the potential benefits deriving from market-oriented reforms.¹⁷⁷ However, the major push to corporate governance reforms came from the process of privatisation itself. Indeed, the 1994 privatisation

¹⁷⁵About the 1991 stock-market regulation, see previous chapter. About insider trading, cf. law no. 157, May 17, 1991.

¹⁷⁶Cf. law no. 149, February 18, 1992.

¹⁷⁷The research was coordinated by Fabrizio Barca. See Barca et al. (1994), Capra et al. (1994) and Barca (1996).

law was important in two respects. First, by introducing norms which protected minority shareholders in the soon-to-be privatised companies, reformists were free to experiment without any particular resistance from the blockholders of existing private companies. Second, it created a contrast between privatised companies and other listed firms which did not conform with a transparent governance structure (Enriques, 2009, 7).

Concrete action towards a comprehensive reform of corporate governance was taken in 1996, when the Parliament delegated to the executive the power to transfer several EU directives into the Italian legislation.¹⁷⁸ Besides importing the Capital Adequacy Directive and the Investment Services Directive, the Parliament gave the government also the task to consolidate financial market regulation into a single law.¹⁷⁹ According to the provision, the government had to “amend the laws on listed corporations with specific regard to the board of internal auditors, minority shareholder rights, shareholder voting agreements and intra-group transactions, with a view to strengthen the protection of savings and minority shareholders” (Enriques, 2009, 9). Hence, in order to undertake this task, the Treasury established a technical committee under the leadership of Director-General Draghi. This decision was certainly controversial. In fact, influential voices criticised the fact that such an important reform was being implemented behind closed doors and away from a wider political debate (Scalfari, 1997). Hence, an enquiry was opened at the lower house of the Parliament in October 1997 (Lonardi, 1997). The ‘Draghi’ reform – as it was soon nicknamed – met the opposition of the centre-right and Confindustria, the major business association. In particular, the issue of mandatory takeover bids was the most controversial point (Repubblica, 1998; Puledda, 1998a; Scalfari, 1998). However, in spite of such resistance, the reform was eventually passed in late February 1998 and came to be known as the consolidated law on finance (*Testo Unico della Finanza*, TUF).¹⁸⁰

TUF envisioned a new regime of corporate governance in favour of shareholder value. It was an “omnibus law that aggregated, reformulated and renewed virtually all civil and criminal rules pertaining to capital markets, securities management,

¹⁷⁸Cf. law no. 52, February 6, 1996.

¹⁷⁹Cf. law no. 52, February 6, 1996, titolo II, art. 21, 4. The Capital Adequacy Directive (Directive 93/6/EEC, March 15, 1993) and the Investment Service Directive (Directive 93/22/EEC May 10, 1993) were imported into Italian law through the law decree no. 415, July 23, 1996.

¹⁸⁰See TUF (1998). Cf. law decree no. 58, February 24, 1998.

institutional investors, brokerage services, public offerings and rules for listed joint stock corporations” (Deeg, 2005*b*, 534). Amongst the key points, the following ones were particularly significant.¹⁸¹ First, the reform increased the protection of minority shareholders through a tighter regulation of shareholder agreements. The latter had to be notified publicly; they could not exceed three years; they were no longer valid in the case of takeover bids (Amatori and Colli, 2001, 43). These measures hit the core of those cross-shareholding practices which blockholders traditionally used to consolidate their relations of mutual trust (McCann, 2000, 51-52). Furthermore, mandatory takeover bids became compulsory once exceeding 30 per cent of the total capital (Puleda, 1998*b*). Second, minority shareholders – identified according to a minimum ownership ranging from 1 to 10 per cent of the outstanding shares – obtained more governance rights. Third, representation of minority shareholders was mandatory at the audit board, the internal body in charge of auditing activities. Finally, the reform reinforced the power of Commissione Nazionale per la Società e la Borsa (CONSOB), the national stock market authority. CONSOB was put in charge of supervising investor protection, the efficiency and transparency of the stock market, and the effective functioning of the market for corporate control. CONSOB could now request ad-hoc information and undertake on-site inspections concerning shareholder agreements and blockholding practices.

Needless to say, the Draghi reform emphasised the importance of the stock market in a country where equity finance had traditionally played a marginal role.¹⁸² In fact, whilst the Draghi committee was drafting the reform of corporate governance, the various national stock exchanges merged in the Milan-based Borsa which was then privatised and began to operate as Borsa Italiana in January 1998.¹⁸³ In a context where declining interest rates made government securities a less attractive form of investment for the wider public – obviously, this was not the case for global arbitrageurs – people looked at the stock market with enthusiasm (Betts, 1997). In particular, the flotation of the recently privatised Telecom Italia mirrored the frenzy for the dot-com bubble in the United States (Rampini, 1997).

¹⁸¹Unless otherwise referenced, the following summary of the ‘Draghi’ reform is based on Enriques (2009, 9-11).

¹⁸²It is important to note that when the ‘Draghi’ reform was enacted, shareholder value had become a major objective also in Europe. About the market-oriented transformation of European corporate control, see Van Appeldoorn and Horn (2007). This dimension was embedded in the wider process of European financial market integration (Bieling, 2006; Mügge, 2008).

¹⁸³For a summary about the privatisation of Borsa Italiana, see BorsaItaliana (1999).

4.3.2 How to hedge the risk of ownership dilution: FIAT and equity swaps

How far did corporate governance reforms transform Italian capitalism into a shareholder democracy? How did the oligarchies react to such a different regulatory environment? It is now time to look at a unique case of market manipulation which shows how the new corporate governance regime did not simply constrain business oligarchies, but also enabled them to use the new institutions and discourses in a strategic sense. This case concerns the car-manufacturer FIAT and its founding family, the Agnellis.¹⁸⁴

In a context of dramatic crisis, FIAT entered a three-year convertible bond of €3 billions with a consortium of eight banks in 2002. As a hybrid of debt and equity, this instrument allowed the holder to convert the bond into the issuing company's stocks – or cash of equal value – at an agreed-upon price. The FIAT's convertible bond had a maturity date that was set for September 2005. More importantly, in the case of insolvency, the bond was to be converted into FIAT shares at a price of €10.3. This conversion implied dramatic consequences for the ownership structure of FIAT. In fact, the 30.6% ownership of the holding Ifil Investments in FIAT – Ifil was controlled by IFI (62%), which was in turn entirely owned by the Agnelli family through the partnership Giovanni Agnelli & Co. S.a.p.a. – would have been diluted of roughly one third in favour of the banks.

In fact, the worst happened. FIAT announced on April 26, 2005 – less than five months before maturity – that the convertible bond was going to be converted into shares. In other words, the Agnelli empire was on the verge of collapse after a century of oligarchic control over FIAT. However, the family found an astute strategy to remain in the 'driving seat' (Economist, 2005). The very same day when the bond conversion was announced, Exor Group – a Luxembourg-based financial holding which was controlled by the Agnelli family via IFI – entered into an equity swap contract with Merrill Lynch International on €90 millions of FIAT ordinary shares.¹⁸⁵ An equity swap would normally be settled in cash. However, the contract between Exor Group and Merrill Lynch included a clause which allowed also

¹⁸⁴Unless otherwise referenced, the following analysis is based on De Nova et al. (2010, 9-11).

¹⁸⁵Exor Group merged with Ifil and IFI in February 2009, forming Exor S.p.A. Today, Exor is the key investment holding which controls FIAT S.p.A. and FIAT Industrial.

the physical settlement. Neither the investing public nor CONSOB were informed about this operation, except for a communiqué on August 24, 2005 in which Ifil and Giovanni Agnelli & Co. told CONSOB that no particular manoeuvre on FIAT shares was taking place. In this dispatch, Ifil and Giovanni Agnelli & Co. nonetheless stated that they intended to keep control of FIAT (Boffano and Griseri, 2010).

How does an equity swap specifically work? This is a derivative contract in which future cash flows are agreed to be exchanged between two counterparties – respectively known as the *equity amount payer* and the *equity amount receiver* – at specific interim dates or in a single maturity date in the future. The equity amount payer transfers to the equity amount receiver the positive difference between i) the spot value of the equity and ii) the *initial reference price* agreed on the contract. On the contrary, the equity amount receiver pays any potentially negative difference between these two elements. On top of this dimension which is typical of an equity future, the two parties enter into a further reciprocal obligation that is the swap element: the payer transfers to the receiver also the dividends generated by the equities in question, whilst receiving an interest rate (e.g. LIBOR or EURIBOR) on the notional capital equal to the value of equities at the moment of the agreement.

In our case, the equity amount payer Merrill Lynch would have paid the equity amount receiver Exor Group the positive performance in relation to the initial reference price of the underlying equity plus the dividends. Merrill Lynch would have instead received from Exor Group the negative performance together with an interest rate on the notional capital – which is equal to the initial reference price multiplied by the number of underlying shares. After this agreement was signed, Merrill Lynch started to hedge by buying the underlying shares. In line with this hedging strategy, Merrill Lynch bought shares on the stock market from April to June 2005, accounting for the 15% of daily trading and 10% of FIAT's voting capital. Accordingly, FIAT share price went up from €4.8 to €6. In accordance with the Italian regulation on takeover, Merrill Lynch communicated that its ownership has reached the 2% threshold but never up to 5%.¹⁸⁶ How is it possible to hide the remaining share of FIAT's voting capital owned by Merrill Lynch?

The investment bank never exceeded the 5% level by 'swapping out' – that is, entering a reverse contract compared to the one with Exor Group – with two other

¹⁸⁶Cf. articles 102-112 of the 1998 consolidate law on finance. see TUF (1998, 88-97).

counterparts, ING bank and Cater Allen International, for a total of 6.5% of FIAT's voting shares. Being in this case the equity amount receiver, Merrill Lynch entered these secondary equity swaps with ING and Cater Allen by transferring to the latter the underlying shares as credit risk collaterals.¹⁸⁷ Hence, both banks also declared they went beyond the 2% threshold. In other words, this is all the market and CONSOB perceived during the period between April and September: three global investment banks merely exceeded the 2% threshold in FIAT's ownership.

In September 2005, when FIAT's convertible bond finally expired, Merrill Lynch had already settled in cash the secondary equity swaps with ING and Cater Allen. At this point, the investment bank bought back the collaterals that were then transferred to Exor Group. Indeed, as already mentioned, the equity swap contained the clause of physical settlement. Eventually, Exor Group bilaterally sold these shares to Ifil, of which participation in FIAT's ownership went simultaneously down to the 30% threshold – due to the convertible bond's agreement – and up the same level as a result of the shares received by Merrill Lynch and its complex equity-swap strategy.

At that time, few voices denounced the Agnelli's abuse of the most basic rules of shareholder democracy (Bragantini, 2005; Penati, 2005). In fact, the authorities intervened very late and the case gained momentum only in the early 2007, when the Milan court began investigating the affair and CONSOB imposed sanctions on the top management of IFI and Ifil – Gianluigi Gabetti, Franco Grande Stevens and Virgilio Marrone (Repubblica, 2007). The main issue at stake concerned the communiqué that Ifil and Giovanni Agnelli & Co. released in late August 2005. Indeed, the latter did not disclose information about the equity swap between Exor Group and Merrill Lynch, therefore constituting an infringement of the current regulation on market communication and market manipulation.¹⁸⁸ In the end, the

¹⁸⁷Let us explain this aspect of collaterals more in details. Each participant in an equity swap is subject to a credit risk exposure to the counterpart. If the underlying share rises in price, the equity payer is required to make a payment in relation to the increase. Conversely, if the underlying share falls, the equity payer is entitled to receive a payment. In the case of these secondary equity swaps with ING and Cater Allen, Merrill Lynch was in the position of equity swap receiver, rather than the payer as it occurred with the principal swap with Exor Group. This means that, when the stock price fell, there was credit risk to the equity payer (ING and Cater Allen) and vice versa. Hence, both ING and Cater Allen mitigated such credit risk by asking the underlying shares as collateral in line with their price movements. For this reason, Merrill Lynch regularly lodged FIAT shares with ING and Cater Allen.

¹⁸⁸Cf. articles 114 (par. 7) and 187-ter of the 1998 consolidated law on finance. See TUF (1998,

investigation was transferred to the court of Turin, the city where the Agnelli family is based. Here, Gabetti, Grande Stevens and Marrone were acquitted in December 2010 (Boffano and Griseri, 2010). After this, the case was brought to court again in June 2012. But, the accusations – this time only towards Gabetti and Grande Stevens – are to be invalidated by prescription in February 2013 (Boffano and Griseri, 2012).¹⁸⁹

To recapitulate, this section has shown how the Olive Tree coalition implemented the shareholder-oriented modernisation of Italian finance. This comprehensive reform aimed at challenging the oligarchic structure of Italian business. Yet, as the case of FIAT has demonstrated, the construction of this new regime of corporate governance did not simply restrain corporate oligarchies. It also multiplied the possibilities to adopt the newly available resources in a strategic sense, ultimately manipulating the very same constraints oligarchs such as the Agnellis were initially subjected to. The next section explores the events concerning municipalities and their use of interest rate swaps. Similarly to the FIAT affair, the case of municipalities shows how the development of new institutions and discourses enabled actors to make use of the newly available structures in tactical terms. In fact, local administrations entered into swaps contracts as part and parcel of a highly politicised move: to circumvent the budget squeeze imposed by the European pact of stability and growth.

4.4 From *finanza derivata* to derivatives finance: how and why Italian municipalities got high on swaps

The historical conditions for local authorities to approach over-the-counter derivatives markets emerged in the mid-1990s. Two intertwined processes were decisive for

99, 143).

¹⁸⁹The case sparked a debate within CONSOB about how to prevent bidders from accumulating undisclosed equity positions through cash-settled derivatives. In September 2011, CONSOB modified the rules of transparency concerning potential shareholdings with cash settlement. Investors are now obliged to communicate also their positions on cash-settled derivatives. Cf. regulation no. 17919, September 9, 2011; http://www.consob.it/main/aree/novita/consultazione_emittenti_20110909_esiti.htm [accessed in December 30, 2012].

municipalities to adopt interest rate swaps: i) the adherence of Italy to the European pact of stability and growth; ii) the decentralisation of fiscal and administrative functions from the state to local governments (regions, provinces and municipalities).

As shown above, Italy faced the imperative to reduce public debt as an overall aggregate over the course of the 1990s. In 1997, the stability and growth pact was established to regulate the adherence of member states to the Maastricht convergence criteria, in particular the maintenance of low budgetary deficits (Heipertz and Verdun, 2005; Cafruny and Ryner, 2008). Inevitably, the path towards a low-deficit regime exerted strong pressures on European countries – their central and local administrative bodies – to reform their financing strategies. In fact, the Italian budget law for the year 1999 included a comprehensive design for the coordination of public finance known as the pact of internal stability (*patto di stabilità interno*).¹⁹⁰ The latter fixed a maximum limit of annual expenditure for local authorities.

At the same time, as reformists transferred EU-imposed budget constraints to the domestic context, they also advanced the benefits of a fiscal and administrative decentralisation.¹⁹¹ The costs and benefits of decentralisation in Italy had been debated since the 1980s, but the process gained momentum only with the first ‘Bassanini’ law in 1997. It was eventually finalised with the consolidated law on local authorities in 2000 and, eventually, the reform of the constitutional law in 2001. The latter granted local authorities wider margins of autonomy in their revenue and expenditure decisions.¹⁹² These reforms opened up new scenarios for local authorities by dismantling the old system of sub-national finance that, up until then, policy-makers had defined as *finanza derivata* (Deputati, 2010, 5).¹⁹³ Here, as the terminology implies, local authorities’ revenues derived from state transfers with the exception of a small income that came from taxes which were levied at the local level. Simply put, the state collected most part of the inland revenues and then transferred funds to local authorities. Moreover, when state transfers were insufficient, local administrators financed their investments primarily through fixed-rate

¹⁹⁰Cf. law no. 448, December 23, 1998. See also Deputati (2010).

¹⁹¹Centre-right forces were also in favour of decentralisation.

¹⁹²Cf. law no. 59, March 15, 1997 (‘Bassanini’ law); law no. 127, May 15, 1997 (‘Bassanini’ bis); law no. 191, June 16, 1998 (‘Bassanini’ ter); law no. 50, March 8, 1999 (‘Bassanini’ quater); law decree no. 267, August 18, 2000; constitutional law no. 3, October 18, 2001. About the autonomy of local authorities, cf. Constitution (1947, art. 119).

¹⁹³Ironically, the very same Italian expression indicates today the use of financial derivatives in their general features.

loans of the public institutes Cassa DP and CREDIOP (Rosati, 2009, 4).

The dismantling of *finanza derivata* created a radically different scenario. Whilst the level of state transfers began to decrease under EU-imposed budgetary limits, local authorities gradually obtained more autonomy in their revenue and expenditure management. In this context, they faced the necessity of approaching financial markets, instruments and actors beyond the traditional public sphere (Saccomanni, 2007, 17). In a word, local authorities began to move within new institutions and discourses of a financialised kind. Interest rate swaps emerged as fundamental practices of this new environment. As a council member of a Southern-Italian municipality explained in a bizarre comparison, “swaps became very fashionable... bank brokers contacted budget *assessori* relentlessly... just like solar-panel companies are doing today.”¹⁹⁴

The construction of a regulatory framework concerning the use of swaps in local finance mirrored the course of events. Regulation acknowledged swaps for the first time in 1996. Local authorities were allowed to issue bonds since 1994 and, in this regard, they were obliged to enter into currency swaps contracts when bonds were denominated in foreign currencies.¹⁹⁵ Besides currency swaps, there was no specific regulation concerning the adoption of other types of swaps by local authorities up until the period 2001-2004.¹⁹⁶ It is only at this point that a specific regulatory framework was put in place to discipline the growing use of interest rate swaps and other derivatives in local finance.¹⁹⁷ Although this regulation was updated in few occasions, its basic pillars remained substantially unchanged until the summer of 2008, when the government enacted the current moratorium on the use of derivatives by

¹⁹⁴Interview, August 31, 2012, my translation. The interviewee agreed that the information given to me was not be individually ascribed. Italian municipalities are governed by a mayor (*sindaco*), a municipal executive (*giunta comunale*) and a municipal council (*consiglio comunale*) as the legislative body. Cf. law decree no. 267, August 18, 2000. Members of the executive are called *assessori comunali*. Each *assessore* has responsibility for a specific department such as budget, urban affairs, sport and so on. Members of the council are known as *consiglieri comunali*.

¹⁹⁵Law no. 724, December 23, 1994, art. 35 validated the use of bonds in local finance. For what concerns the specific use of currency swaps, cf. ministerial decree no. 420, July 5, 1996. The latter authorised the procedural aspects of law no. 724. For this and the following regulatory steps concerning derivatives activities by local authorities, see http://www.dt.tesoro.it/it/debito_publico/enti_locali/nota_espl_normativa_enti_territoriali.html [accessed on December 30, 2012].

¹⁹⁶The use of derivatives by private actors was instead regulated by the 1998 consolidated law on finance.

¹⁹⁷Cf. law no. 448, December 28, 2001, art. 41; ministerial decree no. 389, December 1, 2003; Treasury memorandum no. 128, May 27, 2004.

local authorities.¹⁹⁸ In particular, municipalities were allowed to use for hedging purposes plain vanilla instruments such as: currency swaps, interest rate swaps, forward rate agreements, amortising swaps and interest rate options (caps and collars). What is more, they could implement operations of debt restructuring but not with the objective of postponing the maturity of the initial debt. These operations could not include an upfront sum above 1% of the notional amount and an ascending flow of payments by the local authority over the duration of the contract (Franco, 2009, 18-22). Besides the internal controls at the municipal level, the Ministry of Economy and Finance was in charge of monitoring derivatives activities by local authorities and to transmit the data to the Supreme Audit Court on a regular basis. Although the Bank of Italy and CONSOB had no specific supervisory role concerning public finance, they were both in charge of controlling the operations of financial intermediaries and their derivatives trading with local authorities and private actors (Rosati, 2009, 9-11, 15-18).

At this point, two central questions arise: why did municipalities adopt these instruments? Why did the phenomenon become controversial? Under growing financial constraints, municipalities attempted to make a virtue of the newly available practices. The common economic understanding shows that these actors aimed at optimising the costs of the debt portfolio by restructuring the debt position. This was done in the attempt to free part of those financial resources which were previously used to serve the debt, therefore generating more liquidity in the municipal budget at a time in which the latter was drying up. For instance, in the case of a municipality in the Apulia region, the operation of debt restructuring consisted of closing over 60 fixed-rate loans – of the total value of over €10 millions – which were contracted with Cassa DP in the period between 1997 and 2004.¹⁹⁹ At the same time, the municipality issued fixed-rate bonds (3.75%) for the same value and with a 20-year maturity.²⁰⁰ A specialised bank assisted the issuing process in all its phases

¹⁹⁸About the moratorium, cf. law no. 133, August 6, 2008, art. 62; modified by law no. 203, December 22, 2008.

¹⁹⁹The following case is based on two interviews (September 04-05, 2012) with the head of the financial services of the municipality in question, as well as the official documents which were kindly provided by the interviewee after an official request to the mayor. The interviewee agreed that the information given to me was not be individually ascribed and the name of the municipality was not to be mentioned – although the official documents concerning the specific swap operation are publicly available via official request to the mayor.

²⁰⁰Municipal bonds are known as buoni ordinari comunali (BOC).

and underwrote the entire lot of municipal bonds. In other words, the municipality had the opportunity to extinguish its debt (loans) with Cassa DP and issued bonds to “catch the opportunity arising from favourable levels of market rates” (interview, September 04, 2012, my translation). The interest rate swap entered the picture in 2006. How did it work in practice?

The very same bank proposed the municipality to enter into a fixed-to-floating interest rate swap. It is important to remember that the swap does not substitute the previous commitments which the municipality had on the 20-year-maturity bond. As already mentioned in the technical excursus of this thesis, the swap is a completely distinct contract that works like a bet. In the fixed-to-floating case of the Southern Italian municipality, the bank was the fixed-rate payer whilst the municipality was the floating-rate payer. In this type of swap, the nature of the bet is that the fixed-rate payer has a negative flow of funds towards the floating-rate payer when the interest rate goes down and vice versa. In our case, due to the interest-rate scenarios, the municipality had initially a positive flow of funds. In practical terms, the municipality still paid a fixed-rate of 3.75% on its bonds, but this interest was discounted of certain basis points in line with the funds which derived from the swap bet in variable terms. The problem was that, as interest rates rose, the initial positive flows turned negative for the municipality. Hence, the opportunity was not as attractive as it had been in the beginning. This is the moment when the phenomenon became controversial.

In general terms, many other municipalities across the country experienced the same negative circumstances. In December 2005, 310 municipalities had a negative exposure to derivatives for a market value of €343 millions. By December 2007, the number went up to 619 municipalities for a negative market value of €686 millions. In March 2009, after the 2008 moratorium, the number of municipalities went down to 440 for a negative market value of €575 millions. It is important to note that these data account for municipalities only. If we include other local authorities, the negative market value goes up to over €1 billion in March 2009. What is more, these data concern only the operations of financial intermediaries which operate in Italy. However, bigger local authorities usually dealt with foreign operators the market quota of which accounts for roughly 60%. In other words, the above-mentioned data represent an approximation by defect of a much wider issue (Franco, 2009, table 9,

26-29).

Apart for the common economic rationale behind the use of swaps by municipalities, there is another dimension of the story which takes us to the realm of power relations. In fact, by looking at several specific cases, it becomes clear that municipalities got high on swaps because of a key element of such instruments: the *upfront* (Sanderson, Dinmore and Tett, 2010). This is a sum which the bank advanced to a given municipality to set the contract in a market-neutral position. It happened when the swap was of a ‘non-par’ type, meaning that, when the two parties entered into the contract, the swap presented a negative market value for one of the two parties – in this case, the municipality. As a result, the bank brought the contract to a par condition by advancing an upfront sum to the municipality which should be equivalent to the negative market value the local government was exposed to at the signing of the contract (Rosati, 2009, 1-2). This aspect presented a crucial accountancy artifice. Municipalities considered the upfront as a revenue rather than a debt. For this reason, they circumvented the budget constraint (15% debt-to-revenue ratio) imposed by the pact of internal stability. In other words, they increased artificially the revenue side of the ratio whilst leaving the debt-side unchanged. Paradoxically, the upfront turned into a virtue to be used for purposes of mass consensus (Carlini, 2010). Indeed, as Rachel Sanderson, Guy Dinmore and Gillian Tett (2010, *my italic*) pointed out:

[i]n the revolving-door world of Italian local politics, each new administration wanted its own upfront, so asked their bankers to restructure the deal to release more cash in advance. The terms of the swap tended to become more restrictive each time. Some banks covered the cost of the upfront fee by pricing the interest rate swap more aggressively, so that only in unusual circumstances would the entity receive more each period than it paid out [...] In other cases, upper and lower limits on the movement of interest rates ensured the upside for the local authorities was reduced and downside risks were magnified.

Banks jumped on such an easy profit opportunity by using a simple declaration form in which the treasurer of a given municipality agreed to be considered as *operatore qualificato* (professional investor), meaning that she was able to understand the

maths of complex financial risks.²⁰¹

4.5 Conclusions

This chapter has explored the distinct traits of derivatives-based risk management in Italy. The study has claimed that Italian neoliberal reformists introduced derivatives as fundamental tools which served their strategies against conservative forces. For this reason, derivatives techniques acquired specific contours in relation to the unique power struggles shaping the Italian society.

The first section has shown how technocrats imported derivatives as part and parcel of the renovation of public-debt management in the early 1990s. As they became impatient towards the inability of the *partitocrazia* system to reduce government deficit, technocrats pushed for the marketisation of public debt as a possible solution to reduce the huge costs of debt servicing. This modernisation implied the launch of new practices and technology on primary and secondary markets which the Treasury used in order to manage public debt more actively. Derivatives practices emerged as part and parcel of this public-debt marketisation. They were deemed to make government bonds more attractive to investors.

After this, the chapter has examined the period 1992-1999 when the fight for Europe intensified. In this context, technocrats and centre-left politicians implemented market-oriented reforms and austerity measures in order to conform with the Maastricht convergence criteria. It is in this scenario that these actors engineered the interest-rate convergence between the Italian and German bonds via arbitrageurs on OTC markets (Dunbar, 2000, 149-162). Furthermore, in a very controversial move, reformists arranged also a currency swap which window-dressed the 1997 budget deficit (Piga, 2001, 122-129).

Finally, the chapter has concluded by looking at the modalities through which other agents related to the market-oriented transformation launched by neoliberal reformists. The study has emphasised the enabling character of institutional and

²⁰¹Cf. CONSOB regulation no. 11522 (intermediaries) art. 31, July 1, 1998. See <http://www.consob.it/main/documenti/Regolamentazione/normativa/reg11522.htm> [accessed on December 30, 2012]. Regulation no. 11522 was abrogated by Mifid in 2007 once the Italian jurisdiction received the Markets in Financial Instruments Directive (Mifid) through the decree law no. 164, September 17, 2007. About Mifid, cf. directive 2004/39/EC at <http://eur-lex.europa.eu> [accessed on December 30, 2012].

discursive structures. In this regard, it has shown how the newly advanced institutions and discourses – the shareholder-oriented regime of corporate governance and the dismantling of *finanza derivata* – allowed the Agnelli family and Italian municipalities to adopt swaps in a strategic guise.

Conclusions

It is convenient for the popular discourse to condemn ill-defined external forces rather than looking at one's own closest reality. Unfortunately, by doing so, we often fail to address problems in the most appropriate manner. This is what happened with the controversy about derivatives frauds in Italy. People took for granted what the most immediate evidence showed: Anglo-American finance and its complex practices deceived local administrators who were performing their duty of managing the *res publica*. To be sure, some local politician facilitated these deceitful episodes. Yet, the common discourse preferred to blame the City and Wall Street. It could not have been otherwise in a context where the American subprime crisis was spreading the fear of contagion across the globe, making it incredibly difficult for people to rationalise such critical events in a proper manner. Did anybody ever attempt to problematise this simplistic view about derivatives frauds in Italy? Did anyone pierce the veil of the conventional narrative to explore instead the historical reasons behind the phenomena in question?

Only recently, Alessandro Penati (2012) – a professor of finance at the Catholic University in Milan – has argued in favour of banning the use of derivatives by the state. In March 2012, through the pages of *La Repubblica*, Penati has commented on the striking news that Morgan Stanley has terminated a derivative contract with the Italian Treasury at the mark-to-market price of \$3.4 billions.²⁰² The case is simply mind-blowing as both the Parliament and the wider public knew nothing about the existence of this contract. Whilst Italian newspapers have either ignored or underplayed the importance of such event, Penati has broken instead the silence by claiming that an important factor in every budget audit is the ‘principle of the cockroach’: if you see one, it means that many others are moving around the house. Thus, the Treasury should be more transparent in revealing its derivatives positions

²⁰²On the news, see also Dunbar and Martinuzzi (2012).

and counterparty risk. Furthermore, Penati has pointed out that derivatives might be useful instruments for private actors. But, the state is in no way a private actor. Hence, the Italian society should ban the use of the *derivati di stato* in the future to come.

Penati's perspective is certainly honest. However, in spite of his forthright piece, he does not mention how and why the Italian Treasury entered into these derivatives contracts to begin with. In other words, his comment takes no notice of the political-economic dynamics which led Italian officials to engage with derivatives markets. On the contrary, this is what this thesis has tried to attain. It has aimed at exploring the expansion of derivatives in the Italian context by looking at the agents populating the country's political-economic affairs. The work has shown that, although Anglo-American finance certainly set in motion powerful dynamics, domestic actors played a crucial role in appropriating the institutions and discourses of derivatives-based risk management in Italy. Indeed, Italian neoliberal reformists adopted this innovation as an essential constituent of their power strategies vis-à-vis conservative forces. They exploited derivatives as the most ruthless artifice which served the objectives of joining EMU and overhauling the traditional traits of Italian capitalism.

Main findings of the thesis

The thesis has examined derivatives in Italy by engaging with the problématique concerning the distinct trajectories of financialisation across societies. Several scholars have recently begun to explore the important question of how and why the practices of financialisation reach areas outside the Anglo-American economies – where these phenomena originally manifested themselves (Engelen, Konings and Fernandez, 2010; Gabor, 2010; Kaltenbrunner, 2010; Marois, 2011; Orsi and Solari, 2010; Paineira, 2010; Stockhammer, 2008). These studies represent an important research avenue that aims at improving the analytical resources of a first generation of works which – as shown in chapter one – was inattentive to the diverse nature of financialisation. However, in undertaking this research task, it is crucial to understand that such first generation of studies tends to reveal methodological deficiencies which prevent the analysis from capturing the differential traits of financialisation. Hence, it is necessary to address these problems in order to articulate the complex

interaction between local and global power relations in an appropriate manner.

What are these methodological flaws? How can they be tackled?

As this thesis has argued in chapter one, financialisation scholars are prone to conceptualise the power of finance as consolidated in social structures, an exercise which allows them to theorise the general dynamics of financialisation. Here, agency enters the analytical picture in a passive way. It is seen as an act of resistance against structural power. In other words, although agency exists, it is nonetheless emptied of its political-economic resources. It is not properly examined, but merely understood as an opportunity which hardly ever occurs. In sum, power and agency oppose each other (Knafo, 2010, 497-499). *This view on agency in opposition to structural power is the key problem which sets the financialisation debate on the wrong path.* In fact, once agency is deprived of its strategic capabilities, there is no analytical space to capture the agents who construct and continuously manipulate the institutions and discourses of financialisation in a differential manner, across societies and depending on context-specific power struggles. As a result of this structural bias, financialisation ultimately appears as a replication of similar institutions and discourses everywhere else. Hence, it is crucial to open up the dimension of agency in order to explore how and why the practices of financialisation emerge across social spaces in distinct ways.

How is it possible to explore agency in a productive way?

In order to address this question, the thesis has advanced the agency-centred approach as a way to reconsider how we think of financialisation. From this vantage point, the study has reinterpreted social reality as an environment where actors interact with each other through mediating institutions and discourses that are constantly subject to manipulation. The most important aspect of this method is that *power does no longer reside in the structures of society, but it is instead produced by agents when they innovate extant institutions and discourses.* They do so in the attempt to leverage their own actions over others (Knafo, 2010; Konings, 2010b). The thesis has demonstrated the relevance of the agency-centred approach in relation to the case of derivatives in Italy. In particular, *it has captured how and why Italian*

actors – through their power struggles as well as their institutional and discursive manipulation – created distinct traits of derivatives-based risk management across social spaces.

Where did derivatives come from?

In order to understand how and why these instruments were adopted in the Italian context, it has been necessary to explore first their origins and evolution in the United States. In fact, as chapter two has shown, derivatives assumed their modern features in the American context and, from here, these practices were then exported to other societies. To be exact, derivatives-like contracts existed for a long time before they appeared on US commodity markets (Swan, 1999). Yet, it is only here that these tools were systematically disconnected from the final delivery of the underlying commodity during the late nineteenth century. This innovation generated a surge in speculative activities which clashed with the interests of the rising populist movements. At this point, representatives of commodity exchanges recast derivatives trading and its speculative practices as essential resources for the management of business-risk. In the end, this idea was institutionalised in such terms (Levy, 2006). Hence, the institutions and discourses of derivatives-based risk management consolidated.

Still, as long as the majority of contracts were traded on organised commodity exchanges, derivatives-based techniques did not yet reveal their full potential. It was only in the early 1970s – once American power relations turned in favour of finance – that Chicago exchanges successfully lobbied for the introduction of financial derivatives on their trading pits (MacKenzie and Millo, 2003; MacKenzie, 2006). In this regard, the discipline of financial economics provided scientific legitimacy by describing derivatives as tools which protect investors from the risk of financial market volatility (Wigan, 2009).

During the 1970s, derivatives trading expanded but several regulatory uncertainties still remained. Once these issues were solved in the early 1980s, derivatives grew in size and rate of innovation, becoming essential components of American financial power in the global economy. Three markets were particularly remarkable: index derivatives, asset-backed securities and, above all, swaps. According to

the mainstream narrative, swaps emerged as useful instruments through which investors hedged their risk exposures to interest rates and exchange rates (Markham, 2002*c*, 192). That was true to a certain extent. But, at a non rhetorical level, swaps were simply the perfect tools which companies and financial actors used to avoid regulation and window-dress their books (Partnoy, 2009, 47). Over the course of the 1980s, as derivatives trading expanded, other societies began to adopt its practices as well.

What made the Italian society adopt derivatives in distinct ways?

In Italy, it was once neoliberal-minded forces launched an attack on the country's conservative establishment that the institutions and discourses concerning the use of derivatives emerged in their specific traits. As chapter three has explained, Italian capitalism historically evolved through complex ownership synergies between private business oligarchies and the expanding public enterprise (Segreto, 1998). This private-public liaison produced incredibly dysfunctional dynamics during the 1980s, the most emblematic symptoms of which were the huge growth of public debt and the collusive expansion of the stock-market. It is at this historical juncture that pro-market technocrats at the Bank of Italy and the Treasury Ministry advanced a critique of Italian capitalism which praised public debt reduction, the privatisation of the state-owned sector and, some years later, the modernisation of Italian finance in line with the ideology of shareholder value. In so doing these actors aimed at dismantling the pillars which secured the reproduction of conservative politics-cum-business affairs.

Technocrats gained influence during the late 1980s at a time when the European single market and the project of monetary integration were launched. The political-economic establishment and the popular discourse were very supportive of Europe (Quaglia, 2011). Hence, taking advantage of this environment, they advised politicians in favour of adopting market-oriented reforms such as the liberalisation of capital movements, the transformation of public banks into joint-stock companies and the independence of the central bank. However, it was particularly during the intergovernmental conference on EMU that technocrats obtained considerable decision-making power over the policy contents of the negotiations. Here, by ad-

hering to the Maastricht convergence criteria, they imposed an external constraint on the ability of ruling elites to dissipate public finance (Dyson and Featherstone, 1996). At this point, whilst the bribery scandals of *Tangentopoli* brought the old political regime to a total collapse, technocratic forces finally captured the executive power and had the chance to implement neoliberal reforms systematically (Sbragia, 2001). Derivatives practices emerged in Italy under such circumstances.

As chapter four has examined, technocrats adopted derivatives as part and parcel of the renovation of public-debt management. During the 1980s, as government debt increased considerably, they looked at all possible strategies to reduce the costs of debt servicing. Of course, they became impatient towards the inability of the political class to reduce public expenditure. In this context, technocrats renovated the management of debt in a market-oriented fashion. This transformation included the introduction of new practices and technology on primary and secondary markets which allowed the Treasury to manage its debt in an active manner. This aspect was supposed to help save on the debt costs (Giovannini, 1997). Derivatives were introduced together with this public-debt renovation. They were deemed to make the market for government bonds more attractive to investors.

So far, nothing particularly controversial had emerged yet. But, once the fight for Europe intensified, *technocrats – soon joined by centre-left politicians – adopted derivatives as essential elements of their strategies*. These actors implemented draconian austerity measures and reforms in line with the objective of joining EMU in 1999. In so doing, they also unfolded two derivatives-based tactics. First, the Treasury and the Bank of Italy encouraged LTCM and other hedge funds to arbitrage the interest-rate convergence between Italian and German bonds on OTC markets (Dunbar, 2000, 153). Second, the Olive Tree coalition not only continued this battle for interest-rate convergence, but it also entered into a currency swap which window-dressed the budget deficit for the crucial year 1997 (Piga, 2001, 122-129).

How did actors other than neoliberal reformists relate to the market-oriented modernisation of Italian capitalism?

As the last part of chapter four has shown, the enabling qualities of institutional and discursive structures allowed the Agnelli family and Italian municipalities to

use themselves derivatives in a highly strategic manner. In fact, against a corporate governance regime attuned to the ideology of shareholder value, the Agnellis made use of equity swaps in order to hedge the risk of ownership dilution. Municipalities joined instead the market for interest rate swaps en masse with the aim of avoiding the budget restrictions which resulted from the European stability and growth pact.

Financialisation in Italy

This thesis has dealt with a crucial facet of financialisation in Italy: how and why key actors used derivatives for political-strategic purposes. This dimension clearly indicates that the Italian political economy actively embraces financial innovation. Of course, although of the utmost importance, the tactical adoption of derivatives is not the only aspect showing this process. There are also other events which would deserve to be examined, but doing so exhaustively would lay beyond the scope of this work.²⁰³ Nonetheless, it is beneficial in these concluding remarks to touch upon a few data that can shed light on the general dynamics of financialisation in Italy.²⁰⁴ As it is shown, this phenomenon had an expansionary phase in the late 1990s and early 2000s. After this period, it evolved in an attenuated form without nonetheless sparing the country crisis-ridden episodes such as the case of derivatives.

From the late 1980s onwards, neoliberal-minded forces aimed at reforming the traditional power structure of Italian capitalism. Dismantling the old practices of state-led finance was a key factor in this project.²⁰⁵ The main financial reforms can

²⁰³For instance, it would be relevant to study how several centre-right administrations led by Berlusconi adopted securitisation in the period 2001-2008. During these years, the Minister of Economy and Finance Giulio Tremonti launched Europe-biggest disinvestment of state-owned real estate by securitising these assets. This opaque operation – known by the acronym of SCIP (*Società Cartolarizzazione Immobili Pubblici*) – was a populist move set up to gain consensus on the basis of deceitful macroeconomic data. It avoided raising taxes or cutting expenditure without breaching the deficit ceiling of 3 per cent as imposed by European legislation (Munter, 2004; CorteConti, 2006, 34). In the end, the securitisation process resulted in a colossal failure which favoured urban speculation to the detriment of state finances and the right to housing.

²⁰⁴In this regard, a caveat is necessary. Demonstrating Italy's degree of financialisation in quantitative terms is a difficult task. To be sure, scholars deploy several metrics to gauge finance-led dynamics. However, as this thesis has shown, financialisation is not a process to be appreciated primarily in its quantitative proportions. The phenomenon rather requires to be explored as a qualitative transformation driven by context-specific power relations.

²⁰⁵Following a classification given by John Zysman (1983), the Italian model of state-led finance – as it developed since the 1930s – was characterised by four intertwined elements. First, firms' external financing was based on loans from banks (short-term) and SCIs (long-term). As a result,

be summarised in nine points.²⁰⁶ To begin with, banks and capital markets were privatised and transformed into joint-stock companies. Second, the post-war separation between short-term and long-term credit was removed. It became possible for banks to engage in universal banking and to hold company shares in their portfolios. Third, capital markets – equity and debt securities – were reorganised and deepened in their activities and rate of innovation. Fourth, a new regime of corporate governance was built in favour of shareholder-value ideology. Fifth, the central bank was made independent of political authorities. Sixth, money markets were fully integrated at the European level. The functioning of segments such as treasury bills, interbank funds and repos changed monetary policy into a mechanism aiming at open-market operations instead of direct administrative policies. Seventh, innovation spread also to the instruments and practices in use by market participants. In this regard, derivatives markets and securitisation were the most emblematic cases. Eighth, new actors such as mutual funds and pension funds entered the scene. Ninth, the system of regulation was enhanced and shared amongst the Ministry of Economy and Finance, the Bank of Italy and Consob as the securities markets authority.

In sum, Italian finance was renovated in a market-based fashion during the last two decades.²⁰⁷ This transformation of the country's financial system profoundly shaped Italian capitalism as a whole by 'hybridising' its traditional traits with the practices of Anglo-American financialisation.²⁰⁸ As already mentioned, this process was at its peak in the late 1990s and early 2000s. However, as of the mid-2000s – and

both equity and private bonds played a relatively marginal role in the economy. Second, state ownership in banks and other financial institutions was very high. This aspect allowed political authorities to determine the allocation of capital to specific purposes. Third, the regime of corporate governance favoured 'insiders' (state, blockholders) and reduced the influence of 'outsiders' such as institutional investors and minority shareholders. Fourth, central banking was highly dependent on the Treasury. The neoliberal transformation of Italian finance entailed taking apart these traditional mechanisms and replacing them with innovative market-oriented procedures.

²⁰⁶The following nine-point review is based on Ciocca (2005).

²⁰⁷It is important to note that these reforms fall short of giving Italy a high rank in the index of financial development computed by the World Economic Forum. In the last years, Italy has fallen from the 21st position to the 30th in the ranking. The index accounts for: a) factors, policies and institutions (institutional environment, business environment, financial stability); b) the level of financial intermediation (banking services, non-banking services, financial markets); c) the level of financial access (commercial and retail users). See the reports at <http://www.weforum.org/issues/financial-development> [accessed on December 31, 2012].

²⁰⁸Richard Deeg (2005*a,b*) has accurately explored how the modernisation of the domestic financial system affected the Italian model of capitalism as a whole. He claims that "[financial] systems are at the core of each national economy and changing them has ripple or knock-on effects throughout" (Deeg, 2005*b*, 522).

particularly after the 2007 subprime crisis – many of those elements which initially signalled the expansion of financialisation in Italy eventually weakened. This current situation is visible in the following indicators.

Figure 4.2 shows the evolution of the Italian financial markets from 1990 until 2010. In particular, the data concern the stock-market capitalisation, outstanding domestic public and private debt. As it is clear, the stock market expanded dramatically during the 1990s under the influence of privatizations. However, it began to shrink by the mid-2000s to then hit the same bottom level of 1990. The market for public debt plays instead the dominant role amongst the three. Of course, this is due to the significant size of the Italian government debt. Finally, the market for private debt increased moderately throughout the period in consideration. Figure 4.3 compares the depth of Italian financial markets with other advanced economies. The graph is for the year 2000 when the Italian stock market was at its peak.

Figure 4.4 shows the role of institutional investors in Italy during the last decade. It is remarkable the drastic decline in mutual funds, whilst insurance companies increased their assets. For what concerns pension funds, these are not major actors in Italian finance because the country has a pay-as-you-go social security system. These levels are far lower than what experienced in the US. Indeed, the assets owned by American mutual funds have reached a value of 80 per cent of GDP in 2011. US pension funds' assets have stood instead at about 70 per cent of GDP.²⁰⁹

Besides the depth of financial markets and the role of institutional investors, the increasing use of risky assets by households was an aspect where Italy experienced a considerable growth. In this regard, household financial wealth shifted from bank deposits to instruments the value of which is more exposed to volatility risk. Table 4.1 shows that – together with a remarkable increase in their financial wealth – households expanded the use of products such as equities and mutual funds. Still, it is important to consider that Italian households were still very prudent, revealing a ratio of financial assets to debt of 6.6 in 2003 (Erturk et al., 2005, table 4).

Finally, as suggested by Engelen and Konings (2010, 614), let us look at securitisation as a 'proxy' for financial innovation in the Italian context. In this case, the situation is different compared to the above-mentioned indicators. In fact, Italy is amongst the major issuers of securitised assets in Europe. Table 4.2 shows this

²⁰⁹US data are based on World Bank Global Financial Development at <http://data.worldbank.org/data-catalog/global-financial-development> [accessed on December 31, 2012].

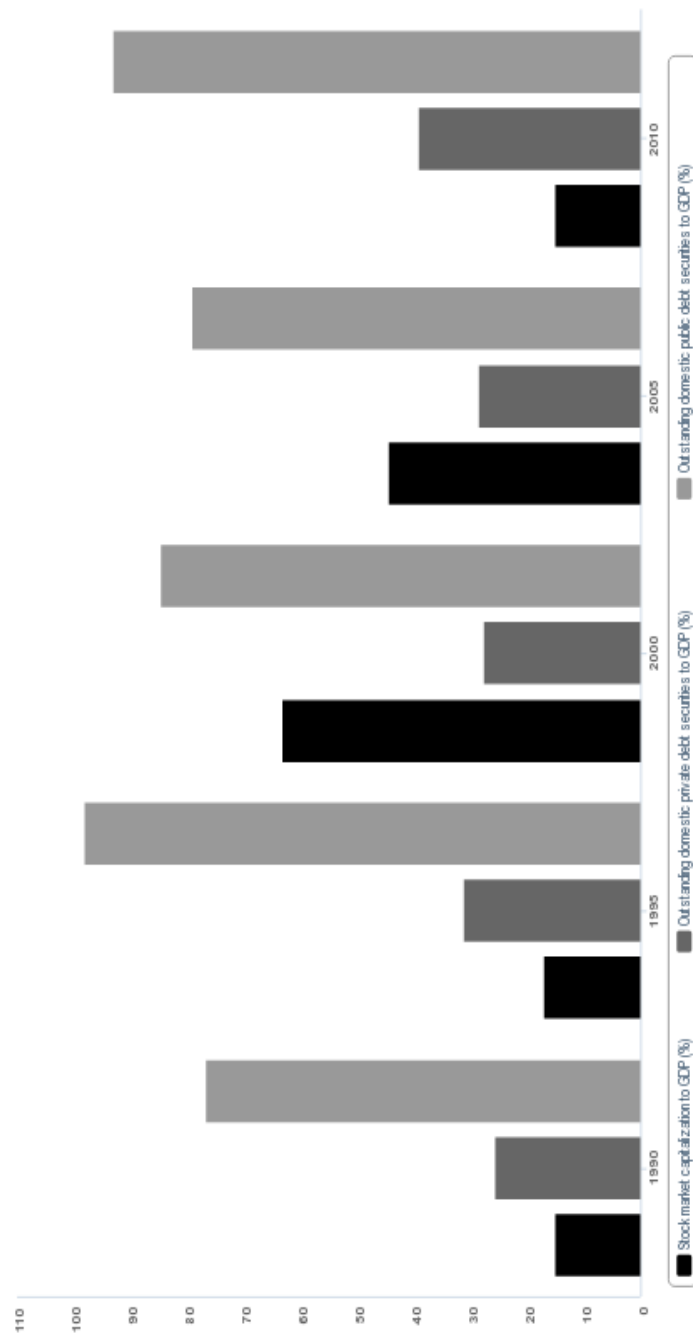


Figure 4.2: Stock-market capitalisation, outstanding domestic public and private debt in Italy, 1990-2010 (% of GDP).

Source: World Bank Global Financial Development at <http://data.worldbank.org/data-catalog/global-financial-development> [accessed on December 31, 2012].



Figure 4.3: Stock-market capitalisation, outstanding domestic public and private debt in Italy, US, UK, France and Germany, 2000 (% of GDP).

Source: World Bank Global Financial Development at <http://data.worldbank.org/data-catalog/global-financial-development> [accessed on December 31, 2012].

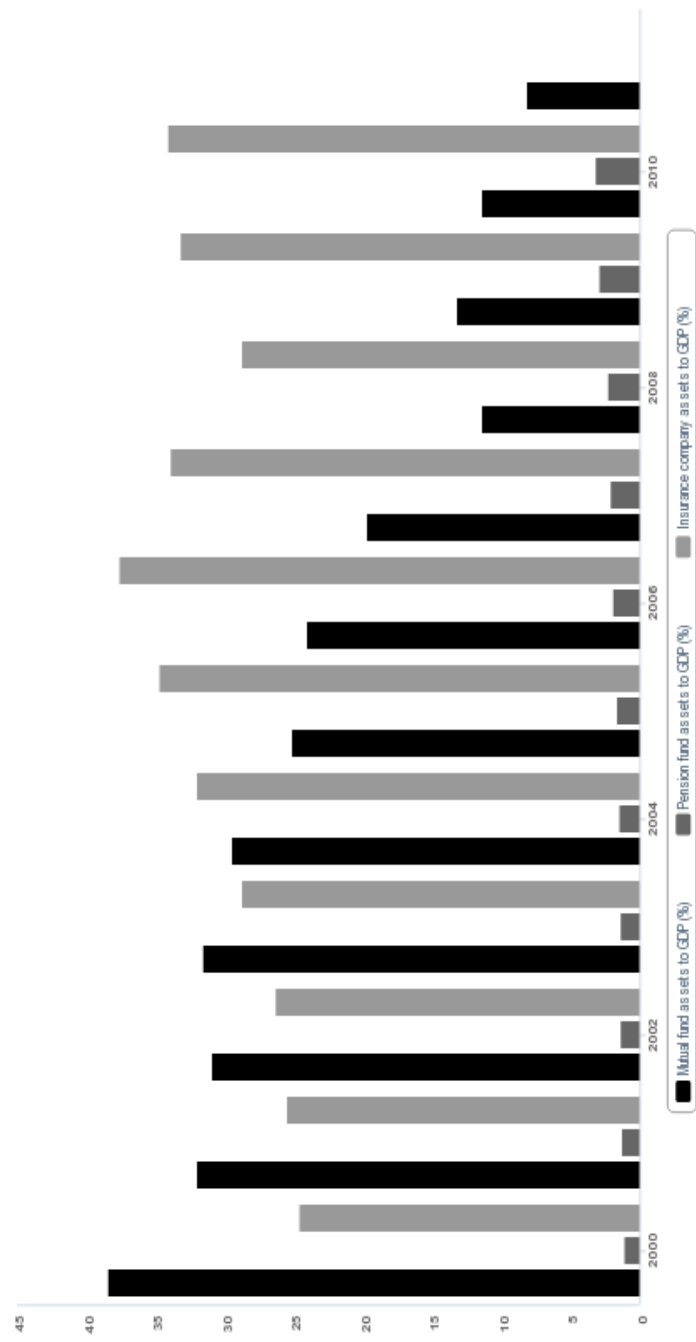


Figure 4.4: Assets of institutional investors in Italy, 2000-2011 (% GDP). Institutional investors are mutual funds, pension funds and insurance companies. Source: World Bank Global Financial Development at <http://data.worldbank.org/data-catalog/global-financial-development> [accessed on December 31, 2012].

	1987	1995	2000	2003
Deposits+cash	50.9	74.3	58.5	60.5
Bonds	39.9	48.8	43.7	49.3
Gov. bonds	36.2	40.8	16.5	15.2
Stocks	12.1	27.2	66.2	49.3
Quoted stocks	-	5.5	16.5	10.5
Mutual funds	7.1	7.4	39.4	27.4
Insurance and pension funds	6.6	18.6	28.3	35.9
Total fin. assets	123.9	178.1	237.8	223.6
Fin. Liabilities	8.1	22.8	30.2	33.9
Net fin. wealth	115.9	155.2	207.6	189.7

Table 4.1: Household portfolios and financial wealth in Italy (% of GDP), 1987-2003.
Source: adapted from Erturk et al. (2005, table 1).

	Italy	UK	Netherlands	Spain
2006	110.9	431.8	113.9	143.6
2007	112	468.8	145.8	177.5
2008	161.3	615.5	202.5	229.2
2009	204.5	617.6	219.2	249.6
2010	222.1	632.2	321.3	297.4
2011	213.4	575.5	314.9	280.9

Table 4.2: European securitisation outstanding by country of collateral, 2006-2011 (€billions).

Source: own elaboration from data by AFME Securitisation Data Report at <http://www.afme.eu/Divisions/Securitisation.aspx> [accessed on December 31, 2012].

aspect by using data from the Association for Financial Markets in Europe (AFME) – a lobby group which has recently integrated the former European Securitisation Forum.

Implications for future research

Whilst putting forward the significance of the agency-centred approach to the study of derivatives in Italy, this work recognises some limitations which would necessitate of more research. Let us mention three issues which are particularly relevant to this thesis and worthy of note here.

First, in exploring the specificities of derivatives in Italy, the work focused primarily on the neoliberal modernisation which occurred over the course of the 1990s. This is the period when the institutions and discourses of derivatives-based risk management acquired distinct traits in relation to the agential power of pro-market reformists and their strategies. In this regard, more interviews with key market participants and public officials – as well as more research on authoritative documents (published or unpublished) and media sources – would be necessary in order to gather data on the interaction between the Italian state and over-the-counter derivatives markets in the 1990s. This is quite a hard task to accomplish considering the opacity of OTC markets and the fact that, thus far, the Italian government is not obliged to reveal its derivatives positions to the public.

Second, it would be important to examine how the scenario evolved after Italy joined EMU. In particular, it would be useful to further investigate the derivatives operations which both the state and the local authorities undertook. For what concerns the latter, more research is needed with regard to the following points: the specific reasons for which local authorities entered into derivatives contracts; the details concerning the client-broker interaction; which banks played a pivotal role; whether these actors built the contracts themselves or were conduits for other national or foreign banks; the accountability of administrators towards the public.

Third, more comparative work would be necessary in order to weigh the significance of the Italian case vis-à-vis other societies and their respective power struggles. Italy certainly stood out amongst other European countries for the cunning ways in which actors deployed derivatives-based strategies. Yet, similar episodes emerged also amongst German and French municipalities (Dodd, 2010). Furthermore, for what concerns the use of derivatives by the central state, Greece also adopted currency swaps to window-dress public finances (Rappeport, Braithwaite and Oakley, 2010).

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